



GENERAL COUNSEL

VOLUME 1



GENERAL COUNSEL VOL 1

A compendium of Aina Blankson Newsletters

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Aina Blankson, General Counsel is a publication of Newsletters, Legal Opinions and Articles of the various practice groups of the Firm. The findings, interpretations and conclusions in this publication are drawn from various sources of reference.

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"Each of us should aim at turning in original research papers for in-house reading on regular basis of at least one paper a month. The policy should be "POP" (Publish or Perish"). The emphasis should be "to dare" and not correctness. Practice makes Perfect! Each Newsletter should be as far as possible accurate both in the information it publishes and the professional view it represents. The language must be formal and clinical. There lies its integrity! The Firm must develop the tradition of accuracy, originality, and consistency in this as in all other endeavours. This is the goal pursued in all the DRG Newsletters so far released. A commentator agreed that the Newsletter on the Electoral Act is profound and correct even though on grounds of self interest he wished it was not released when it was because it undermined his case when it was cited in Court!

We learn every day. If my style so far in my technical guidance function is uncomfortable for anyone I am willing to address that. I do not believe that anyone knows it all and each one of you had taught me something sometime. With open minds and diligence, we can easily attain the expectation of the Firm as envisioned by our very visionary Managing Partner. One more thing, do not always wait for someone to initiate a line and then fall in. Go out in front sometimes! When there is no way, make one!"

**Chief U.N Udechukwu, SAN
Senior Partner, Aina Blankson, LP
in his end of year address to the
Aina Blankson Team**

WELCOME

Dear Reader,

We have come to that time of the year when corporations reflect on the events of the year just gone by and take a critical beam at the promise of the future. For us at Aina Blankson, past years will remain memorable in the annals of our history. Quite apart from Aina Blankson turning twenty, we consummated the most strategic merger in the history of Nigerian legal practice. While we are never coy of our achievements, we embrace our mistakes and learn greatly from our failures. This collection of Newsletters which has now become a reference point in law courts and boardrooms is the outcome of our failure to meet a deadline.

In late 2010, we were presented an opportunity to represent a client in one of the oil rich enclaves, Brunei. The issues were truly novel and in our quest for a thorough research, the client nearly lost the opportunity. That taught us one lesson: preparation is the hallmark for distinction. Opportunities could be lost as quickly if you are ill prepared as today's clients and transactions are no longer just about speed but rather the rate of speed. To this end, we chose to establish the Legal Research Group (LRG) with the sole objective of being our searchlight to the world and preparing for both the present opportunities and the promise of the future. This collection of essays is part of the resultant effect of that preparation. The industry and professionalism exhibited by our LRG Team coupled with the lead role of the firm in financial transactions led the International Financial Law Review 1000 (IFLR 1000), the leading global legal financial reporting group to appoint Aina Blankson in 2011 as the exclusive voice for Nigeria. That voice is our monthly contribution on the IFLR 1000 Global Magazine.

Our General Counsel contains a wide range of developments not just in Nigeria, but internationally, though its thread is largely Nigeria. We wish to thank our clients who raised a number of issues and critiques which informed our areas of focus and afforded us the latitude for this collection. Without the Legal opinions sought, the request for advisory services and the knotty legal questions we were presented in the courtrooms and in the course of transactional work, we might not have addressed a number of the myriad issues that this collection affords. Our greatest asset of all remains the Aina Blankson Team. It is to their credit, especially the members of the Research and Publications Division and the six distinct Practice Group of the firm that this reference material gives credence.

We thank you all!



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"May I register my debt of gratitude to Aina Blankson LP for the profound analysis of issues of law in the newsletter. It is indeed a value-laden and cherished collection. I look forward to subscribing to the newsletter at the earliest opportunity".

Dr. Uwadiogbu Sonny Ajala,
Alternate Chairman, Nigerian Bar Association.

"We write to thank you for your contribution in making 2011 a satisfactory working year for us. Our interaction this year has added appreciable value to us".

Francis O'brien
International Center for Energy, Washington DC.

"I thank you for a copy of your newsletter publication which was received recently. My team and I found the subject matter quite relevant and are putting this in a format to be made available to our entire staff".

Olukemi Onabanjo
Head HR, Ecobank Nigeria Plc

"we are delighted to learn about the appointment of Aina Blankson LP as exclusive representatives of IFLR (the leading global directory of renowned law firms worldwide) for updates on legal developments in Nigeria".

Tijjani M. Borodo
Company Secretary, First Bank Plc

"Their knowledge as captured in their contributions on issues regarding the capital market is very sublime, commendable and worthy of note"

International Financial Law Review (IFLR)

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A large, light gray, stylized letter 'A' watermark is centered on the page. The letter has a thick stroke and a circular cutout in the center. The text 'CORPORATE ADMINISTRATION' is printed in a bold, black, sans-serif font across the white circular cutout.

CORPORATE ADMINISTRATION



CRITIQUE OF THE NIGERIAN CODE OF CORPORATE GOVERNANCE

Introduction

The Nigerian Securities and Exchange Commission ('SEC Nigeria') recently published a Code of Corporate Governance for public companies including, those whose securities are listed on a recognized exchange in Nigeria, as well as companies seeking to raise funds from the Nigerian capital market. The main objective of the Code of Corporate Governance for Public Companies 2011 (the "Code") is to promote good corporate governance practices in public companies in Nigeria and align the Code with international best practices.

This Newsletter examines the provisions of the Code, benchmarking same with similar practices in the United Kingdom (UK) and United States (US)¹, as well as the requirements of the Basel Committee¹.

Corporate Governance Reforms in Nigeria

In 2008, a national committee was inaugurated by SEC Nigeria to address the weaknesses posed by the 2003 Code of Corporate Governance, improve mechanisms for enforceability, and align the Code

¹Basel Committee on Banking Supervision.

²The Code of Best Practices on Corporate Governance 2003.



with international best practices. The result of the national committee resulted in the 2011 Code. The 2003 Code, though voluntary, was applicable to both public quoted companies and all other companies comprising multiple stakeholders in Nigeria. Similarly, the 2011 Code applies to all public companies, including those whose securities are listed on a recognised exchange in Nigeria. Furthermore, it applies to companies seeking to raise funds from the capital market through issuance of securities or listing by introduction.

From the foregoing, it would appear that the 2011 Code, like its predecessor², applies to all listed companies in Nigeria, including banks. This interpretation, however, is not without complications, as Banks in Nigeria are regulated by the Central Bank of Nigeria's (CBN) Code of Corporate Governance for Banks in Nigeria Post Consolidation 2006 (CBN Code). The 2011 Code did not make reference to the CBN Code. Short of the provisions of section 1.3(g) of the 2011 Code, one may be tempted to assume that the CBN Code is no longer applicable. Providentially, section 1.3(g) of the 2011 Code states that in the event of a conflict between the Code and any other code to which a company is exposed, the code with stricter provisions will apply. Section 1.7 of the CBN Code makes it mandatory for banks to comply with its provisions. It would appear, therefore, that banks in Nigeria are required to adopt the provisions of the two codes, provided that they comply with the CBN codes where there is a conflict between the two.

Aside from the 2011 Code which is mostly voluntary³, other corporate governance provisions

³See section 1.3(a) of the Code, which gives states that the Code is only intended to serve as a guide for sound corporate governance practices and behavior.

⁴Cap C20 Laws of the Federation of Nigeria (LFN), 2004; Part

in Nigeria are mandatory. The mandatory corporate governance provisions for companies and banks in Nigeria are contained in the Companies and Allied Matters Act (CAMA) 2004,⁴ the Banks and Other Financial Institutions Act 2004,⁵ the Investment and Securities Act 2007,⁶ as well the CBN Code.

Code of Corporate Governance for Banks in Nigeria

Some of the provisions of the CBN Code are quite distinct from the 2011 Code. It is therefore necessary to point out areas of distinction that may pose conflict.

Induction: Banks must institutionalize and budget for regular training and education of board members on issues concerning their oversight functions.⁷

Composition: There should be a maximum board size of 20 directors,⁸ most of whom should be non-executive directors with at least two of the non-executive directors serving as independent directors.⁹ Such non-executive directors are allowed to hold office continuously for a maximum of 12 years (i.e. 3 terms of 4 years each). The compensation for the non-executive directors is limited to sitting

XI, Section 342 which requires directors to sign the balance sheet for each financial year representing a fair view of the financial affairs of the company, and section 359(3) and (4).

⁵Cap B 3 LFN, 2004: section 28 which requires directors to prepare financial statements for each accounting year that give a true and fair view of the financial affairs of the bank. 6Part B

⁷The 2011 Code only makes it mandatory for directors to participate in periodic professional training to update their skills and knowledge.

⁸This is unlike the Code, which only requires that the membership of the Board should be no less than five.

⁹This provision is certainly more restrictive than the Code, which merely requires every public company to have a minimum of one independent director on its board.

¹⁰The 2011 Code failed to include any such sanction for false

allowance, director's fee and reimbursement for travel and hotel expenses.

Effectiveness: Banks are mandated to engage external consultants to carry out annual performance appraisal of the Board performance. The report of each appraisal should be presented to the AGM and a copy sent to the CBN.

Accountability: The CBN Code permits persons or entities related to members of the Board to provide services to the bank upon full disclosure to the CBN. CEOs and Chief Financial Officers of banks must certify that the returns of their banks represent the true and fair view of their bank. Sanctions for false statement in the return include fines.¹⁰ The CBN may also suspend or remove CEOs of such banks for false return. The officers may also face disciplinary actions from relevant professional bodies.

The CBN Code also requires approval by the Credit Committee of the Board of all applications for credit applications by directors of banks. It also prohibits directors whose facilities have been non-performing for more than one year from sitting on the board of banks. Such directors may also be estopped from sitting on the board of any other bank in Nigeria.

The CBN Code gives the Chief Compliance Officer of each bank the responsibility of monitoring the bank's compliance with the code and making monthly reports of any breach, as well as report of whistle-blowing to the CBN.

Code of Corporate Governance for Public Companies

The provisions of the 2011 Code were highlighted in the February edition of our Newsletter. It analyzed

statements in a company's return.

¹¹Section 5.5(b)

relevant provisions including composition and independence of the board, committees of the board, disclosure requirements and relations with shareholders and stakeholders.

Critique of the Code

The main objective of the 2011 Code is to ensure highest standards of transparency, accountability and good corporate governance, without unduly inhibiting enterprise and innovation. This section examines the implications of some of the provisions of the Code.

Composition of the Board: The Code stipulates that the Board should be of a sufficient size relative to the scale and complexity of the company's operations and composed in such a way as to ensure diversity of experience without compromising independence, compatibility, integrity and availability of members to attend meetings. The minimum number of board membership was placed at 5. This number is quite minimal even for small public companies and may have negative implications where companies decide to adopt the minimum requirement. Agreed, board sizes should not be so large as to be unwieldy. However, companies should be encouraged to maintain numbers that can withstand changes to the Board and Committee composition without undue disruptions.

Board Committees: The Code created three committees as follows: Risk Management Committee, Audit Committee and Governance/Remuneration Committee. It failed to create a Nomination Committee to lead the process of new appointments and make recommendations to the larger board, as only a nomination committee can appropriately evaluate the balance of skills of the board before making recommendation to the larger board for appointments. Similarly, the Code combined the Governance and Remuneration Committees into a Governance/Remuneration

Committee. This committee should be split for effectiveness.

Definition of independent directors: The Code requires an independent director to be free of any relationship with the company or its management which may impair or appear to impair his ability to make independent judgment.¹¹ This definition seems quite strict and all encompassing, and discourages qualified professionals from serving the board for fear of conflict even when they can effectively separate any interest. Lawyers and Accountants for instance, who ordinarily would be qualified candidates for such positions, would not be able to serve in the companies. Even though section 5.5(a)(viii) of the Code makes room for partners or executives of the company's audit firm, internal audit, legal or other consulting firm, who has not acted in that capacity for 3 years prior to their appointment to act as non-executive directors, it still does not give these professionals and others not mentioned, the ability to serve where they are able to so do without any form of conflict.

Furthermore, the Code requires that an independent non-executive director must not be a member of the "immediate family" of a serving or former executive of the company or its group, employed within three years prior to the appointment. No definition is given anywhere as to who constitutes "immediate family" of the non-executive director.

Number of Independent Directors: The Code stipulates that every public company must have at least one independent director on its board who should be a non-executive director. This seems quite minimal if the intention is for them to provide necessary checks on managerial excesses. If large

companies decide to adopt the minimum requirement of one independent director on their board, it would be difficult for such an independent director to fulfill this role.

Family and Interlocking Directorship: The Code stipulates that no more than two members of the same family shall sit on the board of a company at the same time. Once again, the Code failed to define what constitutes "members of the same family." A similar provision in the CBN Code prohibits any two members of the same "extended family" from occupying the position of Chairman and CEO or Executive Director at the same time. The term "extended family" as used in the CBN Code refers to members of a nuclear family comprising the husband, wife and their siblings plus parents and brothers/sisters of both the husband and wife.¹² While banks who are also required to comply with the CBN Code as explained above can adopt this definition, there is no definition to guide other companies in relation to the term.

Joint Chairman/CEO: The Code requires that the position of the Chairman and CEO be separate and held by different individuals. Having a separate Chairman and CEO may be standard practice in some companies (e.g. banks) in Nigeria, but not all. In fact, the most common practice is to have the same person acting as Chairman/CEO of large companies in Nigeria. It may therefore be difficult to get these companies to create separate roles for the two. If mandated to do so, these companies may at best create figure heads for one or the other of the roles with no real separation. In jurisdictions like the UK where separation of roles is standard practice, this would not create problems. However, in the US where regulators have recently required a separation of the two roles, they made it optional for companies to adopt and where they cannot create separate roles, explain why they think having a single person act as

¹²Section 5.2.3 of the CBN Code; footnote 1.ection 5.5(b)

¹³Described as members in general meeting

Chairman and CEO is appropriate. SEC Nigeria could adopt a provision similar to section 31 of the Code, which allows companies to establish a risk-based internal audit function or give sufficient reasons why they cannot.

Multiple Directorships: The Code places no limit on the number of concurrent directorships a director may hold. It however requires full disclosure of the number of directorships to enable the board and shareholders assess the suitability of appointment of the director to the board. Serving directors must also notify the board of prospective appointments on other boards. This seems quite broad. Failure to restrict the number of directorships may cause a director to neglect his responsibilities to some companies. There ought to be some restriction on the number of directorships executive directors or those who have full time jobs in the company should hold or the nature of outside directorship they may hold.

Remuneration: The Code stipulates that the level of remuneration paid to directors should be sufficient to attract and retain skilled and qualified persons needed to run the company successfully. This provision is commendable as it would encourage qualified persons to serve on the board of companies. However, it may be necessary to require the company to avoid paying more than is necessary for the purpose.

Relations with shareholders: The Code requires the board to ensure that shareholders are treated fairly. It stipulates that the venue of general meetings should be accessible to shareholders. It requires that shareholders should play a key role in corporate governance and that institutional shareholders should demand compliance with the Code or seek explanations for non-compliance. It assumes that shareholders have the power to

influence the decisions of management.

The Companies and Allied Matters Act requires companies to act through three organs: the shareholders,¹³ the board or officers¹⁴ or agents.¹⁵ Where authorized by the articles, the board is not bound to obey the directions or instructions of the shareholders and may act contrary to the instructions even if reached in the general meeting.¹⁶ The only avenues for shareholders to check board excesses is to institute legal proceedings requiring the board to act, take steps to amend the article to alter the powers of the directors or remove the directors. However, no alterations shall invalidate prior acts of the board¹⁷. Until recently, Nigerian shareholders were not known for activism and most times only have two options to address any wrongs done by the directors. The first of those options, which is to remove the directors may not be effective as the directors may have committed the wrong before it is discovered, leaving one option, which is to institute court proceedings. Even then, it may take a long time for the case to be decided, defeating the purpose of the suit.

Prior to the privatization of industries in Nigeria, individual shareholdings in public companies were so dispersed that it would have been difficult for shareholders to exert any influence over company management. Privatization paved the way for dominant shareholders to emerge. Institutional shareholders have also become a common feature in Nigeria. Even at that, Nigerian shareholders still have the same apathy towards company management as they had a long time ago. A greater percentage of them still do not attend meetings. Even when they do some have no knowledge of how the company

¹⁴Managing Director

¹⁵Section 63 CAMA.

¹⁶Section 63(4) CAMA

¹⁷Section 63(6) CAMA

shareholders for non-compliance.

Definition of Independent Directors

United Kingdom : The UK Code describes an independent director as one who is independent in character and judgment and has no relationships or circumstances which are likely to affect or appear to affect his judgment. This leaves no room for professionals who are able to separate their interests from the affairs of the company to serve on the board. The UK Code requires at least half of the board to be independent non-executive directors for larger companies and at least two independent non-executive directors for smaller companies.

US: US legislation describes an independent director as one who does not have family, or other significant economic or personal relations to the corporation. Factors considered in determining independence of directors include compensation, fees, relationships with subsidiaries and other conflict of interest. The Dodd Frank Act requires that compensation committee must be independent.

Nigeria: The definition of independent directors in the Nigerian Code is similar to the UK description in many respects, in that it prohibits directors who have relationships or circumstances with the company from serving on the board. However, the Nigerian Code makes room for partners or executives of a law firm or accounting firm to serve after three years of acting in that position. The Nigerian code requires at least one independent non-executive director.

Separate roles for Chairman and CEO

UK: The UK Code requires that the roles of the Chairman and CEO be separate and exercised by different individuals.

US: The Dodd Frank Act²⁰ amends section 14B of the

Exchange Act requiring the US SEC to issue rules to require issuer to disclose in their annual proxy to investors the reasons why it has chosen the same individual or different individuals to serve as Chairman and CEO. This means that once appropriate disclosures are made, a corporation can have one or two different individuals serving as Chairman and CEO.

Nigeria: The Nigerian Code is similar to the UK provision. It requires the roles of the Chairman and CEO be separate and exercised by different persons.

Integrity of Financial Statements

UK: Section 393 of the UK Companies Act 2006 requires directors to approve accounts only when they are satisfied that they give a true and fair view of the company's assets, liabilities, financial position and profit or loss. The UK Code gives the audit committee the responsibility of monitoring the integrity of the financial statements of the company.

US: The US laws require financial statements to fairly represent the financial position of the company. It also mandates the CEO and Chief Financial Officer of every company to certify that the financial statement and related information fairly presents the financial condition and the results in all material respects.²¹

Nigeria: The Nigerian Code, like the UK provision requires accounts of companies to present a true and fair view of the financial position of the company. However, just like the US provision, it requires the CEO and Head of Finance of every company to certify the financial statement.

Whistleblower Program

²¹Section 303 of Sarbanes-Oxley Act 2002

²²Available at

operates, while the few who do, do not receive full information to enable them make informed decisions. In 2006, the case of Cadbury Nigeria Plc illustrated that companies sometimes deliberately overstate their financial position to induce shareholder's vote. Therefore, unless shareholders receive full and accurate information, they may not have the ability to effectively demand board compliance with the Code.

Relations with Stakeholders; Corporate Social Responsibility (CSR) Reporting: The Code encourages transparency with stakeholders and in companies' dealings. It encourages annual reports of environmental, social, ethical, health and safety policies and practices. It also encourages disclosure and stakeholder engagement in companies' CSR strategy which is commendable. It is however necessary to establish mechanisms to enable outsiders confirm company's account of CSR performance.

Whistle-blowing Policy: The Code requires companies to have a whistle-blowing policy and gives the board the responsibility of implementing such policy and establishing mechanisms for reporting unethical behaviors. Interestingly, the Code details mechanisms for reporting such behaviors and merely made a cursory comment in the second part of section 32.2 requiring the board to "continually affirm its support for and commitment to the company's whistle-blower protection mechanism."¹⁸ If all the board is required to do is affirm its support and commitment to whistle-blower protection, then there is nothing to guarantee companies' responsiveness to voluntary whistle-blowing. Nor did the Code make provisions requiring the board to put in place mechanisms to prevent retaliations against whistle-blowers or

¹⁸Emphasis ours

¹⁹See sections 12, 14, 15 of the Code.

remedies against those who suffered retaliations. Unless SEC Nigeria takes steps to effectively protect whistle-blowers, the provisions of section 32.2 of the Code would make no meaningful impact in Nigerian corporate governance.

Comparison with US and UK Reforms

The UK and US have diverse corporate governance systems that ordinarily require no comparison, save for a few similarities. An evaluation of key provisions from the two jurisdictions, however, would provide insights into the Nigerian 2011 Code. Following the global financial crisis and the failure of world corporate governance systems, the UK adopted the UK Corporate Governance Code 2010 (the UK Code) to replace the Combined Code of Corporate Governance, while the US Securities and Exchange Commission (US SEC) recently adopted Final Rules, in response to the Dodd Frank Act 2010. Below are key areas of reforms in the UK and US systems in comparison to the Nigerian system.

"Comply or Explain"

UK: The "comply or explain approach" is the trademark of UK corporate governance and is still used in corporate governance regulation in the UK.

US: The US corporate governance approach on the other hand is based on defined set of rules requiring strict compliance.

Nigeria: The Nigerian corporate governance approach is slightly in between the two. On one hand the Code stipulates flexible adoption as companies deem necessary to facilitate sound corporate governance practices. On the other, it requires strict application.¹⁹ Yet on another, it adopts the UK 'comply or explain approach,' requiring directors to comply with the Code or provide explanations to

²⁰Section 972

UK: The UK does not have provisions similar to the US whistleblower program. The UK Proceeds of Crime Act 2002, however, is slightly similar to the US whistleblowing provisions in that it requires designated officer to reports cases of money laundering. Failure to make the necessary reports attracts severe penalty. In addition, the UK Money Laundering Regulation 2007 requires strict compliance with the requirement for designation of reporting officers.

US: Section 21 of the US Securities and Exchange Act 1934 (Exchange Act) contains detailed provisions on whistleblowing, including requiring that whistleblowers be rewarded. Section 922 of the Dodd Frank Act 2010 has recently amended the Exchange Act by adding a section 21F, which creates a whistleblower program titled "Securities Whistleblower Incentives and Protection."²² It also requires annual report of the whistleblower award program from US SEC to Congress.²³

Nigeria: SEC Nigeria recently included a whistleblowing program in the Code of Corporate Governance requiring directors to establish mechanisms for implementation of the program. The Code, however, made no provision for protection or reward of whistleblowers.

Remuneration

United Kingdom: The UK Code requires that the level of remuneration paid to directors should be sufficient to attract and retain skilled and qualified persons needed to run the company successfully, but that companies should avoid paying more than

http://www.sec.gov/news/studies/2010/whistleblower_report_to_congress.pdf, last assessed 8/4/2011.

²³ Section 21F(g)(5) of the Exchange Act.

²⁴ October 2010; available at

is necessary for the purpose. Non-executive directors may be granted share options upon shareholders' approval and shares purchased in exercise of such options must be held at least until one year after the non-executive director leaves the board.

US: Section 951 of the Dodd Frank Act amends section 14A of the Exchange Act allowing shareholders to have a "say on pay". The amendment requires the board to send proxy or consent or authorization at least every 3 years for an annual or other meeting of the corporation. The board must enclose a separate resolution made subject to shareholder vote, wherein the shareholder shall vote whether or not to approve compensation for the corporation's executives. The shareholders can determine the frequency of vote and can elect to have "say on pay" annually or once every two or three years.

Nigeria: Similar to the UK Code, the Nigerian Code requires that the level of remuneration paid to directors should be sufficient to attract and retain skilled and qualified persons needed to run the company successfully. However, it does not limit payment for necessary purpose. The Nigerian Code also permits all directors including, non-executive directors to take up share options on approval by the shareholders, but stipulates that the option can only be exercised one year after the non-executive director leaves office.

BASEL COMMITTEE'S PRINCIPLES OF CORPORATE GOVERNANCE

As noted above, the Nigerian Code of Corporate Governance applies to banks, as well as a host of other companies. As a result, this section highlights the core principles of corporate governance as laid down by the Basel Committee on Banking Supervision in its document titled "Principles for enhancing corporate governance."²⁴ The principles set out the best practice for banking organizations and are outlined below.

Board Practices: This requires that the board actively carries out its overall responsibility to the bank and provide effective oversight of senior management.

Senior management: Senior management should be under the direction of the board. They should ensure that the bank's activities are consistent with its business strategy, risk tolerance/appetite and policies approved by the board.

Risk management and internal controls: The Committee directs that banks should have risk management functions, compliance and internal control functions, each with sufficient authority, stature, independence, resources and access to the board.

Compensation: The Committee also requires that banks should fully implement the Financial Stability Board's "Principles for Sound Compensation Practices and Accompanying Implementation Standards."

Complex or opaque corporate structures: The board and senior management are expected to know and guide the bank's overall corporate structure to avoid undue complexity. They must also be on hand to address the risks any structure may pose

Disclosure and transparency: Effective disclosure and transparency should be adopted to ensure good corporate governance.

This newsletter discussed the implications of the Nigerian Code of Corporate Governance and drew comparisons with the UK and US rules. It pointed out areas requiring clarifications or amendment to ensure good corporate governance. For some, SEC Nigeria may need to take immediate steps to amend, including the minimum number of independent directors, the power of shareholders to demand compliance, and the provision on multiple directorships.

The Basel Committee's principles for enhancing good corporate governance, though not relevant to companies other than banks, was highlighted to show other measures to further enhance corporate governance practices in Nigeria banks. It is hoped that steps would be taken to adopt relevant principles in the Nigerian system.

CONCLUSION

<http://www.bis.org/publ/bcbs176.pdf>, last assessed 8/4/2011.

HOLDING COMPANY AS A TOOL FOR CORPORATE RESTRUCTURING

Introduction

As the most important source of funding in the entrepreneurial marketplace, Private Equity ("PE") refers to equity securities in private companies that are not publicly traded. A Private Equity Fund ("PEF") as such is a Collective Investment Scheme ("CIS") employed for making investments in various equity securities in accordance with a single investment model linked to private equity. PE funds are in a category similar to limited partnerships, involving a fixed time period of between seven to ten years, which can be extended on an annual basis. These funds are usually marketed to high net-worth institutions.

As a CIS, PEFs reduce the involvement of the investor and relieve him from keeping continuous watch on the stock market or looking for appropriate markets to invest. Usually conceived as closed-ended investments, investors in PEFs typically commit at the outset and afterwards cannot redeem their interests. The funds draw down the commitments from investors as necessary to make a considerable number of investments, and as investments are realized, the proceeds are received and distributed oftentimes without re-investment, thereby making the fund self-liquidating. The fund manager is usually obligated to issue quarterly or semi-annual reports of investments made to investors and inform on other activities undertaken in the period under consideration.

In recent times, PE investments in Nigeria have witnessed considerable growth. Notable investments within the



country include Actis Capital LLP's \$130Million investment in Diamond Bank Nigeria Plc, its \$10.5Million investment in the Palms Shopping Mall (it has since exited from same); Emerging Capital Partner's investment in Notore Chemical Industries Limited,¹ Oando Plc,² IHS,³ African Capital Alliance's investment in MTN Nigeria Communications Limited,⁴ the Associated Bus Company Plc⁵ and Swift Networks,⁶ as well as a host of others. Most PE deals in the country are hinged on management buyout and restructuring, unlike in developed economies where they consist mainly of leveraged buyouts.

The central theme from the foregoing has been the remarkably safe environment in which these investments have taken place. This newsletter discusses the available PEF structure within Nigeria and regulations guiding their investments. Further along, an analysis of PEF structures in the United States of America is undertaken towards appreciating the nature of PEFs.

PRIVATE EQUITY FUND STRUCTURES

The major consideration in structuring PEFs is averting the additional stratum of taxation (otherwise known as double taxation). Typically, the fund will be taxed when it realizes an investment or receives income, and likewise the investor upon the realization of investments in the fund or upon receiving income. For this reason most Nigerian-promoted PEFs are often set up in tax haven jurisdictions such as the British Virgin Islands and Mauritius.

PEFs are mostly set up as incorporated entities under the provisions of the Companies and Allied Matters

Act (the "Act" or "CAMA").⁷ Where set up as a company limited by shares, such PEF (which is a Special Purpose Vehicle through which investments are made) is required by its Memorandum and Articles to state specifically the type of business that it intends to carry out. Where incorporated as a company under CAMA, such PEFs are liable to tax on company income tax. In Lagos state however, most PEFs are set up as limited partnerships under the Partnership Law of Lagos State.⁸ Under this structure, there is at least one general partner (usually the Fund Manager) whose liability for all the debts and obligations of the Fund is unlimited, and other limited partners who are investors in the Fund, but are not liable for the debts and obligations of the Fund beyond their respective contributions. The fund manager manages the fund's business while the fund's investors as limited partners do not participate in the day-to-day management of the business, but may receive certain investment approved rights under the terms of their constituting documents. It must be noted that once the PEF is registered as a limited partnership under the Laws of Lagos State, such partnership can carry on business throughout the federation. Where however, the name of the fund does not include any of the names of its promoters, the provisions of CAMA requires that the name of the fund must be registered as a Business Name under part B of the Act.

SECURITIES & EXCHANGE COMMISSION RULES ON PE INVESTMENTS IN NIGERIA

Prior to the release of the 2011 SEC⁹ Consolidated Rules and Regulations (the "Rules") by the Securities and Exchange Commission ("SEC" or the "Commission")¹⁰, there were no existing specific regulations on the establishment, management and operation of PEFs in Nigeria. Depending on the transaction and investment type, there are a number of specific rules that must be complied with. The Rules subject PEFs operating in the country to authorization and registration with the Commission.¹¹ Where Fund

¹Under ECP Africa Fund II PCC

²Under ECP Africa Fund II PCC

³Under ECP Africa Fund III PCC

⁴Under CAPE I. It exited fully in 2008 through a management sale and private placement.

⁵Under CAPE I. It exited in 2008 through an IPO.

⁶Under CAPE II.

⁷Cap C20, Laws of the Federation 2004

Managers intend to invest the assets of a fund in unlisted securities, they are required to have a minimum paid-up capital of N500,000,000 (Five Hundred Million Naira), unimpaired by losses or such amount as may be prescribed by the Commission from time to time. Further, the Rules require the partners, principals and sponsored individuals to have been in the business of PE investment management for a minimum period of five years.¹² Investment in unlisted securities of a company is only permitted where such investee company has demonstrated compliance with the code of corporate governance; has consistently produced audited accounts for the preceding 5 years; and has a consistent history of profitability for at least the preceding 5 years.¹³

The Rules provide also that PEFs shall not solicit funds from the general public but have their funds sourced from qualified investors alone. They are also not allowed to invest more than 30% of the Funds in a single investment.¹⁴ It should be borne in mind however that the foregoing provisions apply to all PEFs with a minimum investors' funds commitment of N1Billion.¹⁵

LOCAL INVESTMENTS IN PEFs

PEFs may solicit investments from target local investors such as high net-worth individuals, banks, insurance companies and pension funds. Investments by banks, insurance companies and pension funds are however strictly regulated by the Banks and other Financial Institutions Act ("BOFIA"),¹⁶ the Insurance Act¹⁷ and the Regulation on Investment of Pension Fund Assets 2010¹⁸ respectively.

⁸Section 46

⁹Securities and Exchange Commission

¹⁰Rule 550 (1) ©

¹¹Rule 535 (2) (a); Rule 552

¹²Rule 535 (2)(b)

¹³Rule 535 (3)

¹⁴Rule 553

¹⁵Rule 551

¹⁶Cap B3, LFN 2004 (BOFIA)

Under BOFIA, banks are prevented from acquiring or holding any part of the share capital of any financial, commercial or other undertaking, subject to certain exceptions.¹⁹ Subject to the approval of the Central Bank of Nigeria (CBN), banks can invest in any company set up to promote the development of the Nigerian money and capital markets or improve the financial machinery for financing economic development. The CBN prudential guidelines for commercial banks²⁰ however limits the type of investments that commercial banks can undertake to those investments permissible under BOFIA.²¹ In line with CBN regulations, banks can acquire shares in small and medium-scale industries, agricultural enterprises and venture capital companies subject to the condition that the aggregate value of the equity participation of the bank in those enterprises does not at any time exceed 20% of the bank's shareholders funds²² and not more than 40% of the paid up capital of the investee company.²³

The Insurance Act regulates the capacity of insurance companies to invest in Nigeria by mandating that funds of insurance companies must be invested and held in Nigeria²⁴ in certain types of investments. It must be noted that the Act and regulations do not specifically prohibit insurance companies from investing in PEFs, even though they are not listed as permitted investments. Nevertheless, insurance companies have significant PE investments. These investments are required to be disclosed in periodic returns filed with the insurance industry regulator, the National Insurance Commission.²⁵

¹⁷Cap I17, LFN 2004

¹⁸Issued in December 2010

¹⁹Section 21, BOFIA

²⁰CBN Scope, Conditions & Minimum Standards for Commercial Banks Regulations No. 1, 2010

²¹Rule 4

²²Section 21(1)(d)

²³Section 21(1)(c)

²⁴Section 26, Insurance Act

²⁵Section 21, Insurance Act

Prior to December 2010, only Legacy Pension Schemes (CPFAs²⁶ & existing schemes) had PE investments. However, the Regulation on Investment of Pension Fund Assets 2010²⁷ expanded the allowed investment instruments available to pension fund assets to include investment in alternative assets such as PEFs registered with SEC, Supranational Bonds issued by eligible MDFOs,²⁸ Open/Close-ended/Hybrid Investment Funds registered with SEC and other instruments.²⁹

Before Pension Fund Assets can be invested in PEFs, such PEFs are required to have a well defined and publicized investment objectives and strategy; satisfactory pre-defined liquidity and exit routes.³⁰ Further, the Regulation requires that the PEF must have a minimum of 75% investment in companies or projects in Nigeria. Key principals of the Fund Manager (the CEO and CIO) are required to have at least ten years experience in PE investment. Pension funds have a Global Portfolio Limit of 5% of assets under management in the PEF³¹ and such PEFs are required to have MDFOs as limited partners.

FOREIGN PEFs IN NIGERIA

Foreign investments are mainly regulated by the Nigerian Investment Promotion Commission Act ("NIPC Act")³² and the Foreign Exchange (Monitoring and Miscellaneous Provisions) Act ("Forex Act").³³ Both legislations permit investments by foreign investors in Nigerian securities either through the primary or secondary market, or by private placement.³⁴ The respective legislation also provide for the liberalization of foreign direct

investment in Nigeria and permit investors who intend to invest in Nigerian enterprises to do so without the need to seek approvals from numerous regulators.

As with any foreign investor, a foreign PEF (FPEF) i.e., a Fund set up outside the country investing in Nigeria is guaranteed the unconditional transferability of funds through an authorized dealer, in freely convertible currency, of dividend and interest on profits attributable to the investment; payment of foreign loans, as well as capital repatriation in the event of liquidation or divestment.³⁵ Upon importation of funds for investment in Nigeria, an authorized dealer (usually a license bank) through which the funds were imported is required to issue Certificate of Capital Importation (CCI) to the foreign investor (CCI) evincing the amount of capital imported which is meant to be invested in a Nigerian company.³⁶ The CCI enables the PEF to repatriate the proceeds of its Nigerian investments without restriction, net of applicable taxes.³⁷ The provisions of CITA require an investee company to withhold tax at the rate of 10% as final tax on such proceeds at source (that is, dividend in the case of equity investment and interest in the case of loans), before remitting the same to the PEF.

While a FPEF does not require SEC notification before making investments in private companies, portfolio investments in securities of companies listed on the stock exchange require SEC notification and must be made through SEC-registered capital market operators or licensed brokers and/or dealers.³⁸

ACQUISITION OF SECURITIES

In structuring PE transactions, one of the first tasks of the fund manager is identifying an investee company. The nature of the Fund's investment in the investee

²⁶Closed Pension Fund Administrators

²⁷Issued in December 2010

²⁸Multilateral Development Finance Organizations

²⁹Regulation 4

³⁰Regulation 5(2)(11)

³¹Regulation 7(1)(8)

³²Cap N117 LFN 2004

³³Cap F34, LFN 2004

³⁴Section 26(2) Forex Act; see also section 21 NIPC Act and Rule 404 of SEC Rules

³⁵Section 24, NIPC Act

³⁶Section 15(2) Forex Act. See also Rule 406(1) SEC Rules

³⁷Section 15(4) Forex Act

³⁸Rule 408

company could be equity, debt, convertible debt or even a combination of two or more of these types of investments.

Equity investment makes it easier for the Fund to control and monitor the activities of the investee company since the Fund's equity will entitle it to vote at the general meeting of the company and usually participate on the board. The parties may enter into an Equity Purchase Agreement (EPA) to outline the terms and conditions for acquiring the investee company's shares and upon such acquisition, the Fund must ensure that its name is entered in the investee company's register of members. A common provision in the EPA is the delivery of share certificates by the investee company to the PEF.

Where the investment is a private investment in a public entity (PIPE), then attention must be paid to provisions of CAMA on the delivery of share certificates.³⁹ This is because the parties must take into consideration recent steps by the Nigerian Stock Exchange (NSE) to fully dematerialize share certificates of investors holding shares in companies listed on the exchange, through its clearing house, the Central Securities Clearing Systems Limited (CSCS). Shareholders are expected to open CSCS accounts through a stockbroker registered with the Securities and Exchange Commission (SEC) and obtain a CSCS Clearing House Identification Number.

Apart from just being entitled to vote at the general meeting, the Fund will also seek to protect its stake as a shareholder of the company. It could, by way of a Shareholders' Agreement where the investment is a private one, or a Subscription Agreement where the investment is a PIPE, ensure that there are share transfer restrictions and anti-dilution provisions. For example, rights of first refusal, rights of first offer, tag-along and drag-along rights. It is imperative that

the Shareholders' Agreement does not contravene the provisions of the articles of association of the investee company, the CAMA and or any other applicable Nigerian laws or regulations.

In order to ensure maximum returns on its investment, the Fund will naturally be interested in the good governance and management of the investee company. The Fund would thus ensure that the powers of directors to manage the company are exercised in good faith and in the Fund's interests. Accordingly, the Fund would require that the Shareholders' Agreement provides that it has powers to appoint directors, thereby assuring its representation on the board of the investee company, especially on committees such as the finance and audit committees. It should be noted that this could pose a problem of conflict of interest as under CAMA the board of the investee company is expected to act in the best interests of the company and not the Fund.

The Fund may also engage in loan investments. One of the advantages of loan investment by the Fund is a reduction on tax liability arising from the investment. This is because the interest payments that form a return on the Fund's investment will be deducted from the investee company's earnings before tax. Further, the Companies Income Tax Act Cap C21, LFN 2004 (CITA) grants significant tax exemptions (up to 100% depending on the tenor of the loan, including moratorium and grace period) on interest payments on foreign loans.

EXIT MODELS

The most common forms of exits for PEFs in Nigeria are a trade sale, an offer for sale and an initial public offering (IPO). The manner in which the sale would be carried out depends on the type of company and the terms prescribed in the company's articles. Where the articles provide for pre-emptive rights or other constituting documents in favour of other shareholders, the fund may sell its shares to other existing shareholders.

³⁹Section 146

With respect to investments in private companies, the Fund may sell its equity holdings to other existing shareholders. Where the disposal is made at a profit, the profit will not be subject to capital gains tax (CGT), due to the abolishment of CGT on the sale of shares. Upon the sale, the names of the new shareholders will be entered in the company's register of members.

Where the investment of the PEF is a PIPE, SEC Rules provide that a foreign investor shall divest its holdings in securities in public companies through the Nigerian Stock Exchange or on a recognized over-the-counter market with respect to shares traded on that market.⁴⁰ Divestment of holdings in securities in any other public company shall be done through capital market operators⁴¹ The custodian is mandated by the Rules to notify SEC of the particulars of the divestment by the foreign investor within five working days of such divestment.

The Fund could also exit from private investee companies through an IPO. However, IPOs are extensively regulated by the SEC and the conversion of the investee company to a public company will be necessary before the IPO is undertaken. The NSE listing rules require that the company should apply in the prescribed form for listing of its shares on the NSE. Before making the application, certain requirements must be complied with. At least 25% of the share capital of the company having a nominal value of at least N250,000 shall be made available to the public; the number of shareholders must not be less than 300 unless otherwise approved by the Council of the NSE; and the securities must be fully paid up at the time of allotment.

THE US APPROACH

The Limited Partnership ("LP") organized under the laws of the State of Delaware is the most commonly

⁴⁰Rule 410(a)

⁴¹Rule 410(b)

used fund structure in the United States ("US") with respect to domestic private equity funds. While an LP may be formed under the laws of any of the 50 states that comprise the US, Delaware is usually preferred due to its relatively flexible and highly developed laws on limited partnerships and other business entities.

The limited partnership structure for a fund usually comprises a single general partner and multiple limited partners that are investors in the fund. This structure effectively allows the limited partners to limit their individual liability to their commitments to the fund. Usually, the structure of any particular fund will be tailored to the fund's investor base, geographic focus, industry focus and a number of other factors that touch on various tax issues and regulatory concerns.

In the majority of cases, the general partner exists as a separate legal entity owned by the founders of the fund. After setting up the fund, the founders are usually admitted as limited partners in the arrangement, while a limited liability company that is wholly-owned by the founders will be admitted as a general partner, possessing only a small economic interest in the general partner of the fund. In essence, this system accords the founders with limited liability and at the same time, allows them to receive their share of the general partner's carried interest through the limited partnership.

The fund is managed by a management company set up by the founders; and for each fund arranged by the founders, the management company undertakes the responsibility of the day to day operations of the funds. This allows the founders to centralize the management functions of the various funds in one entity. In order to shield the fund managers from liability, the management company is structured as a Delaware corporation or limited liability company.

PEFs that are structured as limited partnerships in the US are regulated by the Securities Act of 1933⁴² which requires amongst others that the sale of securities must be registered with the appropriate regulatory body, unless such offerings qualify for an exemption to the registration requirements.⁴³ Regulation S allows a number of non-US securities offerings to be deemed as occurring outside the US, which in essence allows them to avoid registration. This is only possible where the offer is regarded as an offshore transaction, in which case the offer must be made to non-US entities. The exemptions provided for under sections 3(c)(1) and 3(c)(7) of the US Investment Company Act 1940 provides US PEFs with the avenue to avoid the strict regulations of the Investment Company Act, which would normally require such PEFs to register with the Securities and Exchange Commission as investment companies and be subject to burdensome regulations.

The US Employee Retirement Income Security Act of 1974 as amended (ERISA) regulates investments made by ERISA Plans in PEFs as the fund's assets would be deemed to be assets of the investing benefit plan, thereby subjecting the fund to various onerous rules which typically, these funds have difficulty complying with. By imposing this fiduciary duty on the fund manager, they must then employ their best efforts to cause the fund to qualify for an exemption under ERISA.

The four principal categories of investors in PEFs are non-US investors, US taxable investors, US tax-exempt entities and foreign governments.

CONCLUSION

PEFs are complex transactions, and no less is their structuring. No doubt the Rules has assisted in providing some form of guidance as to operations

of PEFs in the country; nevertheless the contents of the Rules are such that they do not adequately address the growth of PE investments in the country. It is important that a country's PEF structure accommodates the needs of both domestic and foreign investors, as shortcomings in this area could lead investors to seek out alternative foreign structures, which in turn will diminish domestic investors' contributions to the funds in the country.


We advocate that limited partnership laws be promulgated in other states of the federation as they appear to be the most efficient PEF structure world over. Indeed, the most efficient tax mechanism for investments in PE is one based on tax transparency, which does away with double taxation. Tax transparency ensures that investors are only subject to tax in their home jurisdictions. Where this is not available, the attendant effect will be more funds being set up under a foreign structure and investing in the country as FPEFs.

In today's economy, Funds are increasingly becoming accessible to foreign investors and often make investments in more than one country. This inexorably multiplies the complexities involved. Whereas PE investments in Africa are currently dominated by South Africa, Egypt, Mauritius, Morocco and Tunisia, Nigeria is expected to experience a boom in PE investments. Although Nigeria's private equity sector is not yet as vibrant as those of advanced economies, there is no doubt that further economic reforms will continue to make the environment attractive to PEFs. It is hoped that, as private equity transactions increase and the benefits become clearer, an even more conducive legal and tax environment will be created for the operations and establishment of PEFs in Nigeria.

⁴²Regulation D allows issuers to avoid this registration process by offering securities on a controlled basis to accredited investors.

⁴³This is usually referred to as the safe harbour requirement.

MITIGATING CORPORATE RISKS: THE ROLE OF THE BOARD OF DIRECTORS AND RISK OFFICERS



In recent times, the general ambiance in Nigeria has been fraught with insecurity and a myriad of risks affecting virtually all sectors of the economy. While some banks have temporarily shut down operations in some Northern states as a result of insurgency attacks, the kidnapping menace in some Eastern states has forced the shutdown of some industries operations as well as increased emigration of skilled workers¹. More recently, the crash of Dana Boeing MD-83, which killed more than 150 persons, shook the world and is projected to hit US\$100 million in claims².

In the international sphere, among notable corporate failures of Enron and the former Worldcom, are a host of other recent corporate casualties including the JP Morgan Chase (“JP Morgan”) credit trading derivative losses of over US\$2bn (£1.2bn) in the first quarter of 2012, and the US\$200 million losses and intricacies associated with Nasdaq OMX and the Initial

¹Boni Okoro in Article, “Abia: Menace Of Kidnapping” published in The Tide Magazine on July 25, 2011- <http://www.thetidelineonline.com/2010/07/25/abia-menace-of-kidnapping/>

²Dr. Wole Adetimehin, President of Chartered Insurance Institute of Nigeria (CIIN)- Article published by Nigerian Tribune Newspapers on June 6, 2012 -<http://tribune.com.ng/index.php/news/42559-dana-air-plane-crash-claims-may-hit-over-100m-ciin-president>



Public Offering of Facebook Inc. The London trading desk of JP Morgan was identified as the source of the company's loss, with the Chief Operating Officer admitting the company had embarked on a "complex strategy" which exposed the incompetence of its risk management team³.

As corporate risk and monitoring increasingly become an issue for companies globally, the role of directors becomes more important in upholding the duty of utmost good faith. This is particularly in light of increased investor and regulatory scrutiny, increased potential for losses, as well as a business environment that is progressively more complex and global.

The effects of failure to effectively mitigate or manage corporate risk can be measured by lost jobs, bad business and investment strategies, as well as diminished returns on investment and even failed corporate ventures. Companies therefore need to refocus on legal compliance and financial legitimacy which are the main causes of corporate risks.

In view of the foregoing, this Newsletter addresses the role of the Board of Directors and the Risk/Compliance Officer of companies in mitigating corporate risks in line with Nigerian Legislation, as well as a comparative analysis with regimes in the United States of America and the United Kingdom.

The Role of the Board of Directors

³<http://www.ibtimes.co.uk/articles/362809/20120713/jp-morgan-jpm-jamie-dimon-cio-london.htm#ixzz20xyDoeV> last accessed July 2012

The first step towards effective risk management is the realization by the Board of Directors (the "Board") of its responsibility to ensure an efficient management of corporate risks, and subsequently the need for skilled and professional Risk Officers.

It is trite law and generally accepted that, every director of a company has a fiduciary duty to the company. More specifically, the Companies and Allied Matters Act 2004 ("CAMA")⁴ provides that:

"A director shall act at all times in what he believes to be the best interests of the company as a whole so as to preserve its assets, further its business, and promote the purposes for which it was formed, and in such manner as a faithful, diligent, careful and ordinarily skilful director would act in the circumstances."

Therefore it is the responsibility of the Directors to ensure that the interest of the company is at all times paramount in the execution of their duties. This entails ensuring legal and regulatory compliance in the jurisdiction in which the company is domiciled, as well as having in place an efficient risk management system.

As part of their accounting policies, the Securities Exchange Commission ("SEC") Rules and Regulations, 2011 requires public

⁴See section 279(3), CAMA, Laws of the Federation of Nigeria

companies to disclose their risk management framework, as well as the effects of any unmitigated risks on the profitability of the company. The rationale behind this regulation is to protect the investment of shareholders.

Similarly, the Code of Corporate Governance for Public Companies (the "Code")⁵, has certain provisions designed to ensure the sanctity of corporate governance is kept. A key provision of the Code is the requirement placed on the Board to formulate and supervise a risk management framework⁷. The Board is further required to establish a Risk Management Committee⁸ to assist it in its oversight of the risk profile, risk management framework and the risk-reward strategies of its company. An additional obligation imposed by the Code on the Board is the thorough risk assessment which is done annually, covering all aspects of the company's business. In addition, the Audit Committee established by the Board is responsible for ensuring that the risk profile and management process is in place, sufficient and effectively active.

Role of the Compliance/Risk Officer in Mitigating Corporate Risks

According to the article "Rise of the Chief Risk Officer" published by the *Executive Magazine*⁹, revolutions, rogue traders, roller coaster markets and changes in legislation make the risk professional fashionable. Risk

management has undergone massive growth over the years, resulting in an increasing need for Risk Officers ("RO"). While in year 2000, only about 45% of financial services companies engaged the services of an RO, this percentage has increased, as an estimated 80% of companies globally currently have risk officers on their payroll¹⁰.

The operation of the risk officer is a global trend which is set to accelerate further as it is backed with legislation and reinforced with new regulations. In support of this point, the Code of Corporate Governance¹¹ resonates the functions of the risk officers as the personnel in charge of review and approval of the company's risk management policy including its risk appetite and risk mitigation strategy. The Board cannot effectively and directly undertake risk mitigation functions; hence it is vital that it appoints risk officers who would effectively undertake the risk management process for identification of significant risks across the company operations. Risk officers have the obligation to explain risks and countermeasures to senior management and the Board and advise them accordingly.

Further, it is also the responsibility of ROs to review the company's compliance level with applicable laws and regulatory requirements that may impact on the company's risk profile. Most importantly, the ROs proffer solution to impending risks. As such, they directly undertake the whole process of risk identification, assessment, mitigation and monitoring under the supervision of the Board.

⁵Rule 43, SEC Rules, 2011

⁶Issued by the Securities and Exchange Commission in 2008

⁷Section 3 of the Code

⁸Section 10 of the Code

⁹<http://www.executive-magazine.com/getarticle.php?article=14802> last visited June 22, 2012

¹⁰Ibid

¹¹Section 10(2) of Code of Corporate Governance

Identifying Corporate Risk

The first step towards an effective risk mitigation process is a proper diagnosis beginning with identification of existing and/or impending corporate risks of a company. Practically, the RO/Risk Committee meet as a team and identify potential risks which a company is susceptible to in the course of its business.

Risk identification involves a careful study of potential risks including but not limited to the following:

- the nature of the business itself, such as a high degree of regulation, dependence on commodity prices, or environmental risks;
- operating risks, such as customer or plant concentrations;
- financial risks, such as the dynamics of capital sourcing, capital structure, or heavy working or investment capital requirements, and foreign currency fluctuations;
- organizational and human resource risks, such as decentralization, union contracts, and turnover;
- management risks, such as integrity, succession and competence of the management team;
- board risks, such as independence and representation of diverse, strategically important perspectives;
- contingency risks, such as litigation and environmental investigations, risks associated with reliance on outside vendors or partners, etc.

For instance, the RO of a bank would advise on the environmental risk a bank may face where it decides to expand its operations to hostile environments.

Assessing Corporate Risk

Upon proper identification, risks are then assessed based on their potency. Risk assessment is therefore an all-inclusive, focused evaluation of identified risks that may be associated with a company towards highlighting strategies for mitigation.

Risks tend to amplify with rapid growth and change, including such developments as acquisitions, new products, new customers/clientele, management turnover, mergers, takeovers, economic downturns or volatility. To this end, ROs, as well as directors must be especially vigilant in assessing and reviewing risks.

In concert with the Board, a competent RO must design and ensure the implementation of a Risk Assessment Review Program. The program should include the conduct of rigorous and comprehensive risk assessment which will serve as a baseline for subsequent reviews; identifying steps necessary for risk mitigation; ensuring a working framework for follow-up reviews and monitoring of progress made with respect to the risks being mitigated.

Implementation and Monitoring of Risk Mitigation Programs

Where corporate risks have been successfully identified and assessed, ROs in collaboration with the Board, must establish a Risk Mitigation

Program (“RMP”) including risk mitigation policies, to appropriately deal with the risks. This is done by assigning personnel to risks that can be immediately managed, and monitoring those that cannot.

From the example proffered earlier, a bank seeking to expand its operations to an environmentally hostile country, (for instance, an earthquake prone country), must take into serious consideration building with reinforced materials and solid foundation, as well as insurance costs; or a bank incorporated as a public company must mitigate compliance or legal risks by appointing a skilled compliance officer or a professional firm to address all its compliance with the regulatory bodies. These are measures taken to uncover or control risks.

Risk monitoring involves the process of reviewing the RMP with the aim of ascertaining its effectiveness and relevance. Also, Directors are vested with the responsibility of ensuring that the company is not exposed to excessive unmitigated risks by regularly conducting objective and independent reviews of the implemented RMP. The Board must significantly strengthen its capacity to anticipate and assess the warning signs that may herald major problems. Risk mitigation is an ongoing process, including consistent monitoring of risk mitigation goals, implementation progress, and evolving risks to the company. Monitoring mitigation progress enhances long-term viability and stability for the company. Some of the ways through which the Board can monitor this program include:

- Periodic reviews of RMP: the Board should insist on conducting periodic reviews of the RMP with the risk officer(s), to enable them spot warning signals before a crisis ensues;
- Change: It is essential for management of a company to have the ability to differentiate between planned and unplanned change. The Board should carefully monitor change within an organization and recognize that unplanned change can serve as a warning for a variety of risks;
- Adherence to Control Mechanisms: The Board must ensure that there are control mechanisms in place, for example, corporate code of conduct and professional ethics tribunal.
Furthermore, in concert with the RO, the Board must enforce strict adherence to these formalized controls and ensure that these controls are effective;
- Human Capital and Succession Planning: It is imperative for the Board (especially Executive Directors) to understand the company management team and also plan for clear succession plans for Board members and senior management team;
- Transparent Financial Reporting: The Board must work with its internal and external auditors and ensure that its financial statements are constantly prepared; etc.

Comparative Analysis: The United States of America

The Enron/Sarbanes Oxley Act 2002 applicable in the United States of America (“US”),

encourages the Board and ROs to focus on ways to mitigate corporate risks. In the State of Delaware, the courts have formulated national legal standards for directors' duties for risk management by developing the basic rule *in Re Caremark International Inc. Derivative Litigation*¹², that where the Board fails to carry out its oversight function and it causes loss to the company or shareholders, such Board will be liable.

However, more recently, in the *Goldman Sachs Group, Inc. Shareholder Litigation*¹³, decided in October 2011, the court dismissed claims against directors of Goldman Sachs based on allegations that they failed to properly oversee the company's alleged excessive risk taking in the subprime mortgage securities market and caused reputational damage to the company by hedging risks in a manner inconsistent with the interests of its clients.

Similarly, the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act")¹⁴ formed new federally mandated risk management procedures, particularly for financial institutions. The Dodd-Frank Act requires banking companies as well as other financial institutions with total assets of US\$10 billion or more to have a separate risk committee which includes at least one risk management expert with laudable experience in managing risk of large corporations. Likewise, in 2012, the US *Securities and Exchange Commission* included requirements

for statement of a company's Board leadership structure and role in risk oversight. Companies are required to disclose in their annual reports, the extent of the Board's role in risk oversight, such as how the Board administers its oversight function, the effect that risk oversight has on the Board's process and whether and how the Board monitors risk¹⁵.

From the foregoing, the extent to which the corporate environment in the US is given to risk mitigation is evident. The underlying theme behind risk management in the United States is that companies should adhere to reasonable and prudent practices and structure their risk management policies appropriately to cover all ends.

Comparative Analysis: The United Kingdom

In June 2010, the latest version of the Combined Code on Corporate Governance was released by the Financial Reporting Council. The UK Corporate Governance Code ("the Code") introduces some additional principles with the specific aim of improving the efficacy of a company's Board¹⁶. The major amendment to the Code is with regards to the accountability of the Board and the revised risk management and internal control paragraphs¹⁷. The new Code adds "risk management" to the existing

¹²698 A.2d 959, 971 (Del. Ch. 1996)

¹³www.courts.delaware.gov/opinions/downloads.aspx?ID=161650 last visited on June 2012

¹⁴An Act of the Senate and House of Assembly, United States of America. Passed into law on July 21, 2010-
<http://www.sec.gov/about/laws/wallstreetreform-cpa.pdf> last visited June 2012

¹⁵Ibid

¹⁶<http://www.charteredaccountants.ie/Members/Technical/Corporate-Governance/Corporate-Governance-Articles/Risk-Management-and-the-new-UK-Corporate-Governance-Code> last visited June 2012

principles and it requires the sustenance of a sound system of internal control by the Board through its Audit Committee.

Furthermore, the Board is now explicitly responsible for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives. The focal point in the exercise of the Board's role in mitigating risks is with respect to its risk appetite. The new Code therefore proffers that following the new responsibility of the Board in determining significant risks, it is important that the Board align its risk appetite with the vision of the company.

Risk Management in Nigeria

In Nigeria, risk management is an evolving trend. Following the global crisis and the crash in the banking sector in 2008, primarily caused by weak corporate governance and poor risk management practices, the need for organizations to establish appropriate frameworks to manage their risk exposures gained traction. Thus, quite a good number of companies have become conscious of the attendant need to mitigate their corporate risks. The Nigeria Deposit Insurance Corporation ("NDIC") established a new unit called the Enterprise Risk Management Unit ("ERMU") to continuously identify, assess, manage, monitor and control the significant risks that could impede the achievement of the corporation's mandate¹⁸.

¹⁷Ibid

¹⁸<http://www.cenbank.org/supervision/crms.asp>-last visited June 2012

Although there has been noticeable improvement in risk management practices across companies in Nigeria, the practice in the Nigerian corporate environment is still at a rudimentary stage and is beset by a number of challenges. Prominent among these challenges is the dearth of knowledgeable and skilled risk professionals. This is further exacerbated by the pervasive poor knowledge of risk management by members of the Board of many companies and the absence of formal training institutions offering risk management curricula as several risk management practitioners do not possess formal qualification and technical depth, but merely became ROs "overnight".

The Risk Managers Association of Nigeria ("RIMAN") was established in 2000 by a group of risk management professionals, though the Association has not attained legislative recognition. Its vision is towards sustaining best practices and high professional competencies in management of risks in the 'financial industry'. However, as can be gleaned from the discourse above, risk management protracts beyond financial institutions and extends to other sectors of the economy. It is therefore advised that while RIMAN's scope of membership should be expanded, the Association should work towards gaining some recognition with the Government and subsequently work with the National Assembly towards enacting adequate risk management laws in Nigeria.

On the part of the Board and the ROs, risk monitoring is key. The Board should undertake an annual review of the company's risk management system, including a review of

Board-level and Committee-level risk oversight policies and procedures, a presentation of “best practices” to the extent relevant, tailored to focus on the industry or regulatory arena in which the company operates, and a review of other relevant issues such as those listed above.

To this end, it would be appropriate for Boards and ROs to engage professional firms to assist in both the review of the company's risk management systems, as well as assessment and analysis of business-specific risks. In addition, because risks are subject to constant and unexpected changes, Boards should keep in mind that annual reviews do not replace the need to regularly assess and reassess their own operations and processes, learn from past mistakes, and seek to ensure that current practices enable the Board to address specific major issues whenever they may arise. The incidence of new risks should also offer the risk officers an opportunity to thoroughly investigate and report to the Board on appropriate corrective measures.

Conclusion

The risk landscape, with its plethora of different stakeholder groups and strict national and international regulation, is incredibly complex and daunting. This underscores the function of the ROs, Audit Committee, Auditors as well as the Board of Directors of companies in identifying, assessing and implementing risk programs. As a company cannot survive without taking risks, it is imperative that the Board aligns its risk appetite with the set objectives of the company such that it would be able to determine the significant risks, the unavoidable risks and the avoidable risks.

In performing its oversight function, a free flow of information between the Board, senior management, and the ROs in the company is essential. Therefore, a reduction in the play of corporate politics as commonly practiced by companies in Nigeria is advocated. The Board should work with management to understand and agree on the type, format and frequency of risk information required. High-quality, timely and credible information provides the foundation for effective responses and decision-making by the Board.

Thus, the Boards of Directors supervising (or in concert with) the ROs have an immense role to play in ensuring that the company can surmount all attendant risks and stay in business. Companies are therefore advised to institutionalize solid RMPs in order to ensure that the company stays relevant, the reputation of the Board stays unfettered, and the investment of the shareholders stays intact.



FINANCE, BANKING & INVESTMENT



SOVEREIGN WEALTH FUNDS IN NIGERIA: AN OVERVIEW OF THE ENABLING PROVISIONS

Introduction

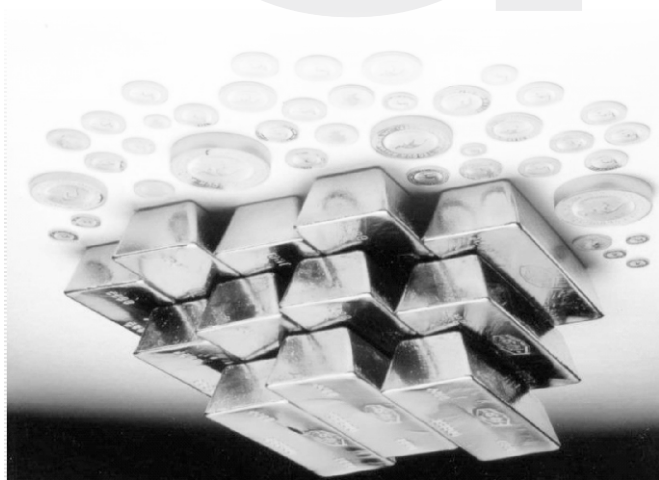
At last, Nigeria joins other nations with advanced Sovereign Wealth Funds (SWFs) to take its place in world economy, as studies indicate that SWFs have become major players in international financial and monetary transactions. There are estimations that by 2012, the assets managed by the SWFs around the world would be about USD\$12 trillion.¹

The International Working Group of Sovereign Wealth Funds (IWG) defined SWFs as special purpose investment funds or arrangements that are owned by general governments.² The IWG identified that SWFs are generally established out of balance payment surpluses, official currency operations, the proceeds of privatizations, fiscal surpluses, and/or receipts resulting from commodity exports.³ Countries with strong SWFs establishments include China with China Investment Corporation, Singapore with the Government of Singapore Investment Corporation, Kuwait with the Kuwait Investment Authority and Norway with the Government Pension

¹Sovereign Wealth Funds available at <http://www.sovereignwealthfundsnews.com/glossary.php>

²Sovereign Wealth Funds Generally Accepted Principles and Practices ("Santiago Principles") October 2008 available at <http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf>; last assessed 28th June 2011.

³Ibid.



Fund. Through their SWFs, these countries invest in a variety of assets ranging from equity and fixed income to alternative assets. Reports indicate that following the sub prime crisis, a lot of international financial and investment institutions resorted to funds from SWFs to shore up their balance sheets.⁴ Morgan Stanley received \$5 billion from the Chinese SWF China Investment Corporation, the United Arab Emirates SWF Abu Dhabi Investment Authority purchased a 4.9% equity share in Citibank, and Merrill Lynch received \$5 billion from Singapore's Temasek Holdings.⁵ Given their antecedents in stabilization and development of world economies, the importance of SWFs cannot be overemphasized.

Nigeria recently expressed her desire to draw from the experience of some of these countries and established a Nigerian Sovereign Investment Authority (NSIA) to save and build assets for its present and future citizens from income from its oil reserves. Success in this venture could make Nigeria a competitive force in international financial transactions as China and the United Arab Emirates, not forgetting a host of other emerging markets, have been in recent years.

This newsletter examines the development of SWF in Nigeria. It examines the international principles and practices relating to SWFs and draws practical analysis from the Norwegian practice.

SWF in Nigeria

In May 2011, the Nigerian government passed into law the Nigeria Sovereign Investment Authority

⁴Raising Capital: The Role of Sovereign Wealth Funds by Anna L. Paulson, Senior financial Economist, Federal Reserve Bank of Chicago, available at http://www.chicagofed.org/digital_assets/publications/chicago_fed_letter/2009/cfljanuary2009_258.pdf, last assessed 28th June 2011.

⁵Ibid

(NSIA) Act 2011 (the "Act") aimed at building a savings base for Nigerian citizens, enhancing the development of Nigerian infrastructure, providing stabilization support in times of economic stress; and carrying out such other matters as may be related to the stated objects. The Act provides for the appointment of a Managing Director of the NSIA whose role is to manage the affairs of the Fund.

NSIA's Framework and Objectives

The Act makes NSIA an independent body capable of holding, acquiring and disposing assets and suing in its corporate name. NSIA will not be subject to the direction and control of any person or authority in Nigeria. The Act specifies that the NSIA will work to provide savings for future generations and also participate in stabilization measures to safeguard the Nigerian economy.

Institutional Framework

The Act provides for the establishment of a Governing Council headed by the President.⁶ Other members of the Governing Council include Governors of the 36 states, the Ministers of Finance, Justice and Planning, the Governor of the Central Bank, the Chief Economic Adviser to the President, Chairman of the revenue, mobilization, allocation and fiscal commission, two representatives of the civil society, four eminent academics, two representatives of the Nigerian youths and two representatives of the private sector. The Council shall in the discharge of its duties observe the independence of the Board and officers of the Authority.⁷ The Board of Directors of NSIA to be headed by the Managing Director shall be independent in the exercise of its responsibilities under the Act.

Functions of the NSIA

The NSIA is required to make investments which will provide supplemental stabilization funding based

⁶S.7(1) of the Act

⁷S.7(2) of the Act

upon specified criteria and at such time as other funds available to the Federation for stabilization need to be supplemented.⁸ All funds are to be invested in accordance with the set policies and procedures developed by the Authority. Some of the other functions of the Authority include:⁹

- developing and fostering skills in asset management, investment, operations, risk management and other related areas in addition to developing expertise in infrastructure project management and auditing capabilities in qualified Nigerian personnel in a manner consistent with the overall financial objectives of the Authority;
- implementing best practices with respect to management, independence and accountability, corporate governance, transparency and reporting on performance as provided in the Act, having due regard as appropriate for the "Santiago Principles"¹⁰ or other similar principles or conventions as may be adopted by the Governing Council;
- attracting co-investment from other investors, including strategic investors, sovereign and internationally recognized investment funds and private companies, to enhance the Authority's capital and maximize risk returns; and
- obtaining the best achievable financial returns on all capital and assets of the Authority having regard to factors including: internationally recognized asset

allocation and risk management principles and practices; opportunities in the International equity, debt, private equity, real estate, infrastructure, fixed-income securities and all other asset classes generally utilized by best-in-class investment fund managers; and also having regard to opportunities and challenges of investing in the international investment market.

Powers of NSIA

The Act grants NSIA power to open branches and subsidiaries in Nigeria and other jurisdictions. NSIA and its subsidiaries may issue bonds or other debt instrument, borrow or raise money in any currency and appoint agents and correspondents to assist in the performance of its functions.

Sources of Funds

The initial Fund to be managed by the NSIA shall be the equivalent of the sum of USD \$1 billion, contributed by the various levels of government in Nigeria.¹¹

In addition, the Act provides that subsequent funding shall be derived from residual funds from the Federation Account provided that the derivation portion of the revenue allocation formula is not included as part of the funding.¹²

Investment vehicles

The Act creates three vehicles for investment namely: Future Generations Fund, Infrastructure Fund and the Stabilization Fund.¹³ The NSIA is to develop investment plans pursuant to the most effective policies and guidance targeted at achieving the aim of such investments.¹⁴ Furthermore the NSIA is

SWFs developed by the IWG and discussed below.

¹¹ S.29(1) of the Act

¹² S.30(1) of the Act

¹³ Part iv, V and VI of the Act

¹⁴ Part IV, V & VI of the Act

⁸Ibid

⁹S.4(2) of the Act

¹⁰A set of generally accepted principles and practices for

empowered to reinvest all realized proceeds and dividends from and interest on portfolio investments of Funds into new or existing assets of the Funds.¹⁵

Future Generations Fund (FGF) The NSIA is required to develop a rolling five-year investment plan for the FGF annually, targeted at providing future generations with a solid savings base for such time as the oil reserves of Nigeria are exhausted, with due regard to macroeconomic factors.¹⁶

Nigeria Infrastructure Fund (NIF) -The NIF is targeted at making investments specifically related to and with the aim of assisting the development of critical infrastructure such as power generation, distribution and transmission, agriculture, dams, water and sewage treatment and delivery, roads, port, rail, airport facilities and similar assets in order to stimulate the growth and diversification of the Nigerian economy.¹⁷ The NSIA is empowered to make financial investments with funds of the NIF pending investments in infrastructure.

Stabilization Fund -The Stabilization Fund is to be established to effectively conduct a sound and responsible fiscal policy, while reducing the effects of the "boom and bust" commodity cycle of oil on Nigeria. The Stabilization Fund is to be invested prudently and in a way that supports the objective of the Fund to be made available to stabilize federation revenues¹⁸. The NSIA may invest in or sell all such assets, and use such derivative instruments for the purposes of hedging or efficient asset management, as may serve such objective.¹⁹

¹⁵ Ibid

¹⁶ S.39(1) of the Act

¹⁷ S.41(1) of the Act

¹⁸ S.47 of the Act

¹⁹ S.47(1) of the Act

External Asset Managers

Perhaps, the most important provision of the Act which reveals the Government's commitment to the success of the NSIA is the provision which permits appointment of external asset managers on the basis of comprehensive assessment criteria, policies and procedures as the NSIA may develop from time to time. By virtue of their extensive research capabilities and experience, external asset managers should ensure prudent investment and asset management which will lead to the success of the SWF.

International Regulation of SWFs

As noted above, the Act mandates the NSIA to implement best practices with respect to management independence and accountability, corporate governance, transparency and reporting in regard to the Santiago Principles. Thus, giving an indication that plans may be underway for the Nigerian SWF to join the International Forum of Sovereign Wealth Funds (IFSWF), established by IWG in 2009. Issues of regulation and transparency of SWFs have always been areas of major concern for SWFs.

The IWG, recognizing that SWF investments are beneficial and critical to international markets, sought to ensure that SWF arrangements are properly set and investments are made on economic and financial basis when it developed the Santiago Principles, a set of Generally Accepted Principles and Practices (GAPP) for SWFs.²⁰

GAPP 1 Principle proposes that the legal framework for SWF be sound and support its effective operation and the achievement of its stated objective.

GAAP 2 Principle requires that the policy purpose of the SWF should be clearly defined and publicly disclosed.

²⁰ Santiago Principles October 2008, *ibid*.

GAAP 3 Principle provides that where the SWF's activities have significant direct domestic macroeconomic implications, those activities should be closely coordinated with the domestic fiscal and monetary authorities, so as to ensure consistency with the overall macroeconomic policies.

GAAP 4 Principle requires clear and public disclosure of policies, rules, procedures or arrangements in relation to SWF's general approach to funding, withdrawal, and spending operations.

GAAP 5 Principle requires timely report of relevant statistical data.

GAAP 6 Principle proposes clear division of roles and responsibilities under the SWF's governance framework to facilitate accountability and operational independence.

GAAP 7 Principle advocates for countries to set the objectives of SWF, appoint members of the governing body and exercise oversight functions.

GAAP 8 Principle makes a case for clear mandate and adequate authority and competency of governing bodies.

GAAP 9 Principle recommends that the SWF's strategies be implemented in an independent manner.

GAAP 10 Principle recommends that the accountability framework for SWF's operations be defined in a legislation, charter or other constitutive document, or management agreement.

GAAP 11 Principle recommends timely preparation of annual reports and accompanying financial statements in accordance with international or national accounting standards.

GAAP 12 Principle recommends annual audit of SWF's financial statements.

GAAP 13 Principle recommends clearly defined professional and ethical standards for members of the SWF's governing body, management and staff.

GAAP 14 Principle recommends that the SWF's operational dealings with third parties should be based on economic and financial grounds with defined rules and procedures.

GAAP 15 Principle recommends that SWF's activities in host countries should be conducted in compliance with applicable regulatory and disclosure requirements of the host country.

GAAP 16 Principle recommends public disclosure of SWF's relevant financial information to demonstrate its economic and financial orientation, so as to contribute to stability in international financial markets and enhance trust in recipient countries.

GAAP 18 Principle recommends that the SWF's investment policy should be clear and consistent with its defined objectives, risk tolerance, and investment strategy, and based on sound portfolio management principles.

GAAP 19 Principle recommends that the SWF's investment decisions should aim to maximize risk-adjusted financial returns in a manner consistent with its investment policy, and based on economic and financial grounds.

GAAP 20 Principle discourages SWFs from taking advantage of privileged information or inappropriate influence by the broader government in competing with private entities.

GAAP 21 Principle recommends that SWFs exercise ownership rights in a manner that is consistent with their investment policies and protects the financial value of their investment.

GAAP 22 Principle expects SWFs to have a framework that identifies, assesses, and manages the risks of their operations.

GAAP 23 Principle requires SWF's report of its assets and investment performance to its national government.

GAAP 24 Principle recommends regular review of level of implementation of GAAP in SWFs.

The OECD also made similar recommendations on transparency and accountability in its 2008 Guidelines for Recipient Country Investment Policies relating to National Security.²¹

The Norwegian Practice

Before now, Nigeria's Excess Crude Account which was established in 2004 had an asset of \$5 Billion, Norway, with a Government Pension Fund currently has the biggest SWF in the World.²²

The Government Pension Fund-Global (GPF), an offshoot of the former Petroleum Fund, established in 1990 is a pool of the surplus wealth produced by the Norwegian petroleum income.²³ The GPF has been said to be among the most transparent of the SWFs in its holdings & investments.²⁴

The strategy of the GPF is based on the objective of high return subject to moderate risk in order to contribute to safeguarding the basis of future welfare, including national pensions. The fund invests globally in a large number of financial instruments, including fixed income and equities. It

also focuses on stocks and bonds, and has achieved broad diversification which has been the reason for its good investment returns with moderate financial risk.²⁵

The Norwegian Ministry of Finance has reviewed the GPF in line with the Santiago principles.²⁶ The GPF utilizes external asset managers, such as Norges Bank Investment Management (NBIM), who are required to comply with ethical guidelines based on sector and company behavior.²⁷ The companies that the GPF invests in are closely monitored by a Council of Ethics, who may make recommendations for withdrawal of funds where the companies' operations are in conflict with the guidelines. The guidelines also prohibit investment where there is a risk that a company is involved in activities that can contribute to violation of human rights, corruption, environmental damage or other particularly serious violations of fundamental ethical norms.²⁸

Conclusion

While the recent Nigerian legislation contains extensive provisions in line with GAAP above, a lot still remains to be achieved in the area of transparency and accountability as well as proper reporting mechanisms. It is hoped that extensive compliance will be achieved in subsequent Regulations, Guidelines and Procedures to be implemented by the NSIA.

The use of external asset managers in NSIA's investments is strongly encouraged in view of the level of expertise these external managers possess.

²¹ Available at

<http://www.oecd.org/dataoecd/0/23/41456730.pdf>, last assessed 28th June 2011.

²² Norway's sovereign wealth fund biggest in the world report available at

<http://www.interaksyon.com/article/5504/norways-sovereign-wealth-fund-biggest-in-the-world---report>, last assessed 28th June 2011.

²³ Sovereign wealth fund Institute - Norway Government Pension Fund Global available at

<http://www.swfinstitute.org/swfs/norway-government-pension-fund-global/>, last assessed 28th June 2011.

²⁴ Ibid

²⁵ Santiago Principles October 2008, *ibid*.

²⁶ The Norwegian Government Pension Fund Norway's adherence with the Santiago principles: available at http://www.regjeringen.no/Upload/FIN/brosjyre/2011/GapSurvey_Norway, last assessed 28th June 2011.

²⁷ *Ibid*

²⁸ *Ibid*

The NSIA would do well to adopt best practices from existing SWFs, such as the Norwegian SWF's practice explained above as well as the Chinese SWF practice, to mention a few. This should help domestically in improving the management of Nigeria's public finances and supporting growth, as well as in placing the country in a strong financial position internationally.

FINANCIAL STABILITY AND DEPOSITOR PROTECTION: THE NIGERIAN BRIDGE BANK MECHANISM

Introduction

Recent events brought into focus the different mechanisms for resolving failing banking institutions in Nigeria, which hitherto were centered on provision of financial assistance. Prior to the recent restructuring, the average Nigerian believed that only two options were open to a bank in financial difficulty: receive money from the government to shore up the bank's capital or be liquidated by the Nigerian Deposit Insurance Corporation (NDIC). Little did most know that the Nigeria Deposit Insurance Corporation Act (NDIC Act) which was passed in 2006 contains other mechanisms by which a bank in dire financial straits may be restructured to infuse confidence within the system and protect depositors of such insured institutions. This newsletter examines the various mechanisms for restructuring failing financial institutions in Nigeria with a special focus on the bridge bank mechanism.

Background

In July 2009, a special audit of the Twenty-Four deposit banks in Nigeria was undertaken by the Central Bank of Nigeria (CBN), with particular focus on their liquidity, capital adequacy, risk management and corporate governance practices.

At the end of the assessment, ten banks were



adjudged to be in a grave state with respect to their capital adequacy. Of these, eight of the banks also had significant deficiencies in liquidity, risk management practices and corporate governance policies. The executive management of these eight banks were immediately replaced by CBN appointed management teams while all ten banks received capital injections of approximately N620billion in the form of Tier 2 Capital. The CBN subsequently set September 30, 2011 as the deadline for the recapitalization of these banks by their management teams.

While two of the banks¹ successfully recapitalized, Union Bank of Nigeria, Intercontinental Bank, Finbank, Oceanic Bank International and Equitorial Trust Bank (ETB) have signed Transaction Implementation Agreements (TIAs), which going by CBN's pronouncements, constitute a significant step towards recapitalization.

However, by a press statement dated 5 August 2011² the NDIC announced the closure of three banks, Spring Bank Plc, Bank PHB Plc and Afribank of Nigeria Plc for failing to show ability to recapitalize by the deadline set by the CBN. Bridge Banks were formed to absorb the assets and liabilities of the three banks as follows: Enterprise Bank Limited³, Keystone Bank Limited⁴ and Mainstreet Bank Limited⁵.

Upon assumption of control, the NDIC sold the

bridge banks to the Asset Management Corporation of Nigeria, the government's established distressed assets manager which injected N675billion into the banks and appointed executive management teams to run their operations.

Thus, this newsletter examines the issues surrounding NDIC's adoption of the bridge bank mechanism while considering similar practices in the United Kingdom (UK) and United States of America (US).

Mechanisms for Restructuring Failing Financial Institutions in Nigeria

The NDIC as a Regulator works alongside the CBN in matters relating to banks and other financial institutions in Nigeria. The NDIC's statutory mandate is four-fold: (a) insure all deposit liabilities of insured institutions;⁶ (b) give assistance to insured institutions in the interest of depositors; (c) guarantee payments to depositors, in case of imminent or actual suspension of payments by insured institutions up to the maximum amount specified in section 20 of the NDIC Act;⁷ and (d) act as liquidator of failed insured institution.

With respect to failing financial institutions, the NDIC Act made provisions for three resolution mechanisms in the event of a crisis. It provides for the grant of financial assistance where an institution has difficulty in meeting its obligations to depositors and creditors, persistently suffers liquidity deficiency, or has accumulated losses which have nearly or completely eroded its shareholders' fund.⁸ Alternatively, the NDIC may take over the management of a failing insured institution until such

¹Wema Bank Plc and Unity Bank Plc.

²NDIC Press Statement available at <http://www.cenbank.org/Out/2011/pressrelease/gvd/NDIC%20PRESS%20RELEASE.pdf>, last assessed 30/8/2011.

³For Spring Bank Plc.

⁴For Bank PHB Plc.

⁵For Afribank Plc.

⁶Section 2(1)(a) of the NDIC Act defines insured institutions as licensed banks and other deposit taking financial institutions.

⁷N200,000 from the Deposit Insurance Fund of licensed banks and N100,000 from the Deposit Insurance Fund of other licensed deposit-taking financial institutions.

⁸Section 37 NDIC Act.

a time as the institution's financial position may improve.⁹

A third alternative is the adoption of a bridge bank mechanism which would allow bridge banks to assume the assets and liabilities of a failing insured institution pending further resolutions or sale.¹⁰

Interestingly, save for the provision on financial assistance which may be made at the request of the insured institution, the NDIC Act failed to mention any event or occurrence that will trigger the adoption of the other two resolution mechanisms.

However, it would appear that some triggering events are contained in the Banks and Other Financial Institutions Act, 2004 (BOFIA).¹¹ That law requires CBN to carry out routine examinations on banks and other financial institutions. It requires the CBN to take legal steps to secure the affairs of institutions as well as protect depositors, where upon an examination it is of the opinion that a bank is in a grave situation.¹² BOFIA also mandates the CBN to turn over the control and management of the troubled bank to NDIC where after taking the requisite steps as above, the affairs of the bank failed to improve.¹³

Significantly, it is only after the NDIC has assumed control of a bank and finds that the bank is undercapitalized¹⁴ that the NDIC may require the bank to submit an acceptable recapitalization plan within a stipulated period.¹⁵ This BOFIA provision seems to

be supported by the definition of a "failing insured institution" under the NDIC Act. Section 59 of that Act defines such an institution as one whose capital to risk weighted assets ratio or regulatory capital is below the minimum prescribed by the CBN.

Events in recent past seem to suggest that bank regulators do not follow this particular provision of the Act.¹⁶ Rather, these events suggest that the CBN as the banking supervisor carries out these examinations, and upon detecting such circumstances which in its opinion amounts to requisite triggers, proceeds to direct the affairs of the banks,¹⁷ while also imposing recapitalization requirements.

Some may argue that such actions by the CBN serve a crucial purpose, which is to ensure stability as well as enhance confidence within the system. Others, including these regulators may argue that because of the constant collaborations between the CBN and the NDIC,¹⁸ due processes are followed in the regulation of banks. However, going by the process adopted in the case of the eight banks cited by the CBN as shown above,¹⁹ the CBN concluded all resolutions including recapitalization before turning over the management of Spring Bank, Bank PHB and Afribank to the NDIC. Little wonder therefore that this mode of resolution generated many furors within the country, especially from shareholders of the affected banks.²⁰

No doubt arguments in favor of stability is supported by the prime position which the CBN occupies in the

⁹Section 38 NDIC Act.

¹⁰Section 39 of the Act.

¹¹Cap B 3 Laws of the Federation of Nigeria 2004.

¹²Section 35 (1)(d) BOFIA.

¹³Section 36 BOFIA.

¹⁴Where the bank's risk weighted assets ratio is below 5 percent but above 2 percent.

¹⁵Section 37 (a) BOFIA.

¹⁶That is section 37 (a) BOFIA.

¹⁷By appointing managers and directors.

¹⁸See section 53 NDIC Act,

¹⁹Page 2 above.

²⁰Issues in bank's nationalization, available at <http://www.independentngonline.com/DailyIndependent/Article.aspx?id=38857&print=1>, last assessed 30/8/2011.

Nigerian economy, as well as section 2(d) of the Central Bank Act, 2007 which imposes on the CBN the duty of promoting a sound financial system in Nigeria. However, such exercise of powers in relation to those conferred on the NDIC still needs to be clarified to enhance certainty within the system.

While it is clear that the CBN may rely on the provisions of section 35 (2)(b) of BOFIA to require a failing bank to take any steps or actions as may be necessary in relation to its business, which in this case could be read to include recapitalization, one question which springs to mind is at what point does the bank get an opportunity to submit recapitalization plans to the NDIC pursuant to section 37 (a) of BOFIA? Can the bank do this while it is still an under-capitalized failing institution under the NDIC management? If so, at what point then does the NDIC have the power to adopt the bridge bank mechanism as a resolution process? If the intention is to have alternative resolution mechanisms, what circumstances would give rise to the adoption of one as opposed to the other?

These are very crucial areas of uncertainty that should be resolved.

The Bridge Bank Mechanism

BOFIA provides for the NDIC to remain in control of a failing bank until such time as the CBN decides that it is no longer necessary to do so.²¹ The NDIC Act also provides that the NDIC may take over the management of a failing institution or direct specific changes to be made in the management of the institution until such time as the financial position of such institution improves.²²

However, while both BOFIA and the NDIC Act contain extensive provisions on how a bank should

be controlled when it is put under the NDIC management, nothing was said under BOFIA in relation to the bridge bank mechanism. One explanation could be that the NDIC Act being a 2006 Act is a more recent legislation. However, as we shall see below, no mention was made under the NDIC Act of the events that would trigger the adoption of the bridge bank mechanism.

The NDIC Act provides for the establishment of bridge banks to assume the assets and liabilities of failing insured institutions.²³ It permits the NDIC to advance funds to aid the operation of such bridge banks, as well as appoint and remove members of the board of directors. Typically, the bridge bank will have a life span of two years from the date it was issued a license²⁴ unless a merger, consolidation or sale causes an earlier termination of its affairs. The NDIC act also made provisions for liquidation of the bridge bank's business upon the end of its life.

Interestingly, the preceding paragraph contains virtually all the provisions on the bridge bank as a resolution process. No supporting provisions were included; the definition included in section 59 of the NDIC Act merely points to section 39 of the same Act which contains the provisions detailed above, giving an indication that the mechanism was included by the draftsman only as an afterthought. There is also nothing to indicate when and how the mechanism should be adopted.

It is possible to argue that the NDIC can validly adopt the bridge bank mechanism as an option for resolution in view of section 39 of BOFIA. That section allows the NDIC to recommend other resolution measures to the CBN in the event that the bank over

²¹Section 38 BOFIA.

²²Section 38 (1)(a) and(b).

²³Section 39 (1).

which the NDIC has assumed control cannot be rehabilitated. However, if that section is strictly construed, it would appear that such “other resolution measures” (bridge bank inclusive) would only be triggered after the NDIC has assumed control of the failing bank, not before. Nothing in the present scenario with Spring Bank, Bank PHB and Afribank, indicates that the NDIC assumed control before recommending the adoption of the bridge bank mechanism.

This is a crucial area requiring clarification to enhance certainty within the system. It is important to specify the events that would trigger the adoption of the bridge bank mechanism. Where the same events as those that give rise to assumption of management and control of a failing bank are intended, rules should be adopted to promote clarity.

NDIC's adoption of the Bridge Bank Mechanism: the case of Spring Bank, Bank PHB and Afribank

As earlier indicated, the three banks having failed the CBN audit in 2009 were subsequently bailed out alongside the other 5 banks and mandated by the CBN to recapitalize by September 30, 2011. While other banks had executed Transaction Implementation Agreements, these three banks were yet to have any plan approved by the CBN, leading to the assumption of their assets by the bridge banks, Enterprise Bank, Keystone Bank and Mainstreet Bank.

The nationalization of the three banks has caused a ripple effect and an outcry particularly amongst investors and depositors. It would appear that the issue which generated a barrage of controversy is not really whether the NDIC has the powers to create bridge banks, but the manner in which the exercise was carried out and its effects, particularly

that the CBN revoked the licenses of the three banks way before the September 30, 2011 deadline for recapitalization.

Some of the fallouts from the nationalization include panic withdrawals in branches of the three banks across the country and more painfully, panic offloading of bank stocks from the exchange.²⁵ Furthermore the shares of the affected banks have been placed on full suspension which implies that the shares would be delisted and therefore no longer in existence. Consequently, shareholders appear the worst hit with N32 billion worth of shares believed to have gone with the three nationalized banks²⁶. A breakdown of the shareholding structure of the banks shows that Spring Bank had 11.3 billion ordinary shares valued at N9.6 billion, Afribank 13.6 billion ordinary shares worth N9.49 billion, while Bank PHB had 20.2 billion ordinary shares put at N10.7 billion. But at the end of trading on August 5, 2011 when the banks were nationalized, the share prices of the banks were N0.64 for Afribank, N0.57 for Bank PHB and N0.84 for Spring Bank.²⁷

The market capitalization of the listed equities on the Exchange, which stood at N7.484tn before the announcement of the nationalization of banks, fell by N339bn or 4.5% to close at N7.145tn as at Wednesday, August 10, 2011.²⁸ Also, the Nigerian Stock Exchange (NSE) All-Share Index which measures the volume of trading was down by 4.5% or 1,061.69 basis points from 23,397.44, down to

²⁴Except extended to a maximum of three additional one year one year periods.

²⁵Udeme Ekwere; **NSE begs investors not to dump shares** available at. <http://www.punchng.com/Articl.aspx?theartic=Art201108118253131>, last assessed 30/8/2011.

²⁶Ibid.

²⁷Ibid.

²⁸Ibid.

22,335.75 points. The NSE-30 Index, which measures the performance of the top 30 stocks, also fell by 5.2% in the same period, from 1,044.69 to 990.12 points.²⁹

These repercussions suggest an apparent lack of certainty within the system. Whilst it is appreciated that regulators should adopt resolution tools that would enhance confidence and stability within the system, these tools ought to be properly aligned with the rights of shareholders of these banks whose interests are affected by the resolution. Thus, the need for clarity on the circumstances that would trigger the adoption of the bridge bank mechanism as well as the other resolution tools cannot be overemphasized.

The UK's Special Resolution Regime

Following the failure of the Northern Rock, the deficiencies of the UK regime to deal with banks in distress which was dependent on the application of corporate insolvency law was exposed.³⁰ As part of the policy response, the authorities enacted the Banking Act 2009 to strengthen the statutory framework for financial stability and depositor protection. The Act established a Special Resolution Regime (SRR), providing the tripartite authorities, the Financial Services Authority (FSA), Bank of England (BoE), and the Treasury with special tools to resolve failing banking institutions. The UK Banking Act indicates that the main purpose of the SRR for banks is to address situations where all or part of the business of a bank has encountered, or is likely to encounter financial difficulties.

The UK regime consists of three parts: the three

²⁹Ibid.

³⁰Peter Brieley; **The UK Special Resolution Regime for failing banks in an international context** available at http://www.bankofengland.co.uk/publications/fsr/fs_paper05.pdf, last assessed 30/8/2011.

stabilization options, the bank insolvency procedure and the bank administration procedure. The stabilization options for failing banks include: (a) transfer to a private sector purchaser; (b) transfer to a bridge bank; and (c) transfer to a temporary public ownership.

The Act provides that the stabilization options may be exercised only when certain preconditions or circumstances are met. These are, that the FSA is satisfied (a) that the bank is failing, or is likely to fail, to satisfy the threshold conditions imposed for carrying on regulated activities under the Financial Services and Markets Act 2000; and (b) that having regard to timing, it is not reasonably likely that action will be taken by or in respect of the bank that will enable it satisfy the threshold conditions.³¹

In addition, special conditions must exist to trigger the BoE's exercise of stabilization powers with respect to private sector purchaser and the bridge bank resolutions tools. Condition³² A requires that the power be exercised where it is necessary, having regard to the stability of the UK financial systems, to maintain public confidence in the stability of the UK banking systems, and to protect depositors. The BoE must consult the FSA and Treasury before making a determination and deciding how to proceed.

The triggers for the Treasury's exercise of stabilization powers are specified in section 9 of the Act. The first condition is met where the exercise of power is necessary to resolve or reduce serious threat to the stability of financial systems of the UK.

Following the implementation of the Act, a Code of Practice was issued in November 2010 to provide guidance on how and in what circumstances the

³¹Section 7 of the Banking Act.

³²Section 8 of the UK Banking Act.

authorities will use the special resolution tools. The Code stipulates that resolution by way of bank insolvency may be the best option where the most appropriate outcome would be the winding up of the affairs of failed institutions in the interest of creditors and where prompt pay outs to eligible depositors or bulk transfer of their accounts to another institution is assured.

Where the public interest considerations weigh in favor of an exercise of a stabilization option, resolution by way of transfer to a private sector purchaser is likely to be the best resolution option if it can be achieved in a cost effective way, and so long as a willing purchaser is readily available.

Furthermore, the Code of Practice explains that resolution by way of transfer to a bridge bank is appropriate where an immediate private sector sale is not possible, and where a stable platform is needed to prepare for and effect the onward sale of all or part of the bank to a private sector purchaser. Temporary public ownership is appropriate only where it is necessary to resolve or reduce a serious threat to the stability of the UK's financial system, such as for instance, where the Treasury has advanced a significant amount of public funds to a failing institution in order to stabilize it prior to its entry into the SRR.

The Act also contains extensive provisions on bridge banks and the transfer of property of a failing bank. It sets out the provisions that a property transfer instrument may contain. It requires that the BoE take appropriate steps to specify in given circumstances which property, rights and liabilities of a failing banking institution have been transferred. It made provisions for operating strategy as well as reporting requirements in relation to bridge banks. As opposed to the Nigerian provisions, the UK regime contains far reaching provisions to promote

certainty within the system.

The US Failing Bank Resolution Process

The Federal Deposit Insurance Corporation's (FDIC) formal resolution process for failing banks typically begins when a financial institution's chartering authority sends a "failing bank letter" advising the FDIC of the institution's imminent failure.³³ This letter provides the requisite trigger upon which the FDIC relies to structure the resolution tool to adopt while it sends out teams to carry out special examination on the failing bank in order to identify the bank's assets and liabilities, as well as value the assets.

Typically, the FDIC may adopt any of these three options with respect to a failing bank: (a) sell all or part of the assets of the failing bank to another bank; (b) pay off eligible insured depositors and dispose of the failing bank's assets; or (c) establish a bridge bank to assume the assets of a the failing bank.³⁴

The FDIC carefully considers the circumstances surrounding the particular banking institution before settling for a resolution process. It notes that when a large bank with a complex structure, such as a multi-bank holding company is in danger of failing, creating a bridge bank allows it to take control of the bank and stabilize it.³⁵ The FDIC lists some of the benefits of adopting the bridge bank tool as: (a) granting it sufficient flexibility to market the bank; (b) thorough assessment of the bank's condition and complete evaluation of alternative forms of resolution; and (c) allowing additional time for due

³³Overview of the Resolution Process available at <http://www.fdic.gov/bank/historical/managing/history1-02.pdf>, last assessed 30/8/2011.

³⁴12 U.S.C. section 1821 (n).

³⁵Bridge Banks available at <http://www.fdic.gov/bank/historical/managing/history1-06.pdf>, last assessed 30/8/2011.

diligence by interested parties without interrupting the day to day operations of the bridge bank for its depositors.

Whilst it would appear that Nigeria adopts similar resolutions tools for failing banks as the US especially with respect to the bridge bank process, it is important to point out here that the US made detailed provisions of not only the circumstances that would trigger the adoption of the process, but also of the operational requirements for such bridge banks.

Conclusion

There is no doubt that the NDIC rose to the challenge of promoting financial stability and protecting depositors, albeit at the expense of the shareholders. The bridge bank option constitutes a veritable tool for enhancing depositor protection and promoting confidence by ensuring seamless continuity of banking operations in spite of challenges in the internal structure of a bank and should be appropriately utilized.

While this paper is not advocating for a wholesale adoption of the UK provisions, it is important for Nigerian regulators to consider a review of some of the provisions relating to banking institutions. Being a recent legislation, the UK SRR may provide some useful examples from which to learn. However, given that the UK market is vastly different from what is currently obtainable in Nigeria, only such provisions that would lead to predictable results and ultimately enhance confidence in the Nigerian situation should be adopted.

DEMATERIALIZATION OF SECURITIES AND INVESTOR PROTECTION IN NIGERIA

The Nigerian Securities and Exchange Commission ("SEC") recently strengthened its sweeping reforms in the newly Consolidated Rules and Regulation which was published in September 2011. While most of the reforms have significant relevance in the Nigerian legal system, one which deserves careful consideration given its place in the Nigerian insolvency regime, in the author's opinion, is the provision on dematerialization of securities. Thus, this newsletter examines the provisions of the Consolidated Rules and Regulation 2011 (the "Rules") on dematerialization of securities vis-a-vis provisions on corporate insolvency in Nigeria.

Background

Historically, only two forms of securities were known to the Nigerian investor and other participants in corporate securities, bearer securities and registered securities. While bearer securities which were mostly associated with promissory notes were less prominent, registered securities dominated the corporate scene for a long time. Bearer securities are issued in the form of a paper instrument; on the face of the instrument is written the promise of the issuer to pay the bearer (or holder) of the instrument¹ The Nigerian Companies and Allied Matters Act ("CAMA"),² however, recognizes securities as registered where the name of the holder of relevant security is included in the register of members of the issuing company and a certificate issued to registered holder.

¹J. Benjamin, *Interests in Securities* (OUP, 2000), 32.

²Cap. 59 Laws of the Federation of Nigeria 2004.



Given the level of its dominance in the Nigerian corporate setting, emphasis was placed on the certificate evidencing securities, which as we shall see later, serves as the prima facie evidence of the title of the registered holder to the security.

Emphasis was thus placed on share certificates as well as certificates of debt securities, such as debentures stocks, resulting in severe hardships to many ranging from risk of loss or theft of certificates to delay in issuing certificates which most often resulted in a shareholder's inability to deal with allocated shares, for instance, prior to receipt of certificate.³ Issuers also faced mounting costs of printing and dispatching certificates to subscribers in addition to other administrative costs.

After years of complaints, SEC responded with the provision allowing investors to hold their securities in dematerialized form.

One way to understand the nature of dematerialized securities is by describing them as uncertificated securities, whereas registered securities will fall under the category of certificated securities.

Securities Holding under the Nigerian Corporate Law

Until recently, CAMA was the main piece of legislation which set standards for companies operating in Nigeria. It made provisions for the sale, acquisition, transfer and registration of securities, which it describes as including shares, debentures, debenture stocks, bonds, notes (other than promissory notes) and units under a unit trust scheme.⁴ In relation to shares, CAMA recognizes only holders whose names are included in the register of members of the relevant issuer.⁵ It states

³Section 152(4) (b) of CAMA specifically authorizes companies to refuse to recognize any instrument of transfer of shares which is not accompanied by certificates of the shares to which it relates.

⁴Section 650 CAMA.

that the share certificates which the company is under obligation to issue to the member on record within a prescribed period, shall serve as prima facie evidence of the member's title to the shares.⁶

One crucial point of significance at this stage is the fact that there is no provision in CAMA, the primary legislation for companies operating in Nigeria, which recognizes securities held in dematerialized form.

In 2007, the Investment and Securities Act ("ISA") was amended from its very first enactment in 1999⁷ to deal with some of the obsolete provisions of CAMA for companies operating in the Nigerian capital market. Section 55 of the ISA permits issue or transfer of securities by electronic means under terms which SEC may prescribe. However, the Rules and Regulations which was made pursuant to the ISA merely made provisions for companies to offer or transfer securities electronically so long as an investor failed to request a share certificate.⁸

Thus, going by that provision, electronic issue or transfer of securities will be invalid where an investor elects to have a share certificate. Also, in several other instances⁹, the Rules required registration and issue of share certificates to ultimate purchasers.¹⁰ These provisions remained in effect until the Rule 26 Amendment published on SEC's website and very recently the Consolidated Rules and Regulation of September 2011 which made extensive provisions on dematerialization of securities.

Some critics may argue that dematerialization is not a recent provision after all, given that the ISA made provisions for electronic issue or transfer of securities years ago in 2007. However, what is important is to

⁵Section 152(2) CAMA.

⁶Sections 147 and 157 CAMA. See also section

⁷The Investment and Securities Act of 1999.

⁸Rule 98 of the New Rules of the Securities and Exchange Commission, published on SEC's website.

⁹For instance securities offered by way of rights.

¹⁰Rule 88 of the New Rules of the SEC

understand that until recently, issuance of securities by electronic means was made subject to investor preference.¹¹

Dematerialization of Securities for Capital Market Operations

The Consolidated Rules defines dematerialization as “the elimination of physical certificates or documents of title that represent ownership of securities so that securities exist only as book entry records.”¹² It gives depositories¹³ the power to state the specific securities that are eligible to be held in dematerialized form including:

- a) shares, scripts, stocks, bonds, debentures, debenture stocks or other securities of like nature in or of any incorporated company or body corporate;
- b) units of mutual funds, rights under collective investment schemes and venture capital funds, commercial papers, certificate of deposit, securitized debt, money market instruments and government securities.¹⁴

It is important to realize here that even though the Rules covered securities “in or of any incorporated company or body corporate,” only those companies or corporations operating in the capital market will be affected. For all other companies who do not have listed shares or operations within the capital market, the rules governing registration and

¹¹See Rule 98 of the New Rules and Regulation of SEC published on SEC’s website. See also Rule 88 of the same Rules.

¹²Rule 148.

¹³Defined in Rule 164 as “custodians who hold securities on behalf of known investors but whose names appear on the issuers’ register as a fiduciary nominee for the benefit of the investor and who operates a system of central handling of securities of a particular class of an issuer deposited within its system and may be transferred, loaned or pledged by bookkeeping entry without physical delivery of certificates.”

¹⁴Rule 168.

certification of holdings under CAMA will apply to make title in shares, for instance, ineffective without registration in the respective names of holders of securities. However, as we shall see below, the distinction in the nature of companies affected by the rules on dematerialization is specifically relevant when the custodian or other intermediary holding the security on behalf of an investor is solvent and in operation, but is immaterial on its insolvency.

Dematerialization and Intermediated Securities

Having described the term “dematerialization” in the preceding section, we would now consider the attendant rights available to an investor of a dematerialized security held by the intermediary.

The International Institute for the Unification of Private Law (UNIDROIT) to which Nigeria is a member, gave an apt definition of the term “intermediated securities” in the Convention on Substantive Rules for Intermediated Securities (Convention),¹⁵ describing it as:

“securities credited to a securities account or rights or interests in securities resulting from the credit of securities to a securities account.”

The Convention defines a securities account as meaning “an account maintained by an intermediary to which securities may be credited or debited,” while an intermediary is defined as:

“a person (including central securities depository) who in the course of a business or other regular activity maintains securities accounts for others or both for others and for its own account and is acting in that capacity.”

Going by these definitions, custodians, participants, central securities depositories and a number of other capital market operators would qualify as intermediaries where they authorized to deal with the

¹⁵Geneva 2009; Article 1.

¹⁶Rule 155 of the Consolidated Rules. See also Rule 185 which

dematerialized assets of the investor.

Intermediary Credit Risk in the Nigerian Capital Market

The primary concern of an investor who entrusts his securities assets in an intermediary is the way to ensure that the assets will not be treated as part of the intermediary's assets, but as separate from the assets of the intermediary. SEC made efforts to protect investors' assets by requiring not only that the assets be separated from that of the custodian or other participant, but also that each investor client's assets be kept separate from other clients' assets held by the custodian.¹⁶ Where full compliance with these provisions can be achieved, such a separation would ensure that the investor is protected from the intermediary's credit risk, on insolvency of the intermediary. However, situations may arise where some intermediaries will find such individual client asset segregation operationally inconvenient and opt to hold assets in a pool of like assets; hence, the need for alternative legal or regulatory protection.

One form of protection could be found in the ISA's requirement for establishment of an Investor Protection Fund, which it describes as "such fund established by a securities exchange or capital trade point pursuant to the provisions of Part XIV of the Act to mitigate losses suffered by investors." Pursuant to the ISA, an Investor Protection Fund shall be established to compensate investors who suffer pecuniary loss arising from:

- a) the insolvency, bankruptcy or negligence of a dealing member firm of a securities exchange or capital trade point; and
- b) defalcation committed by a dealing

also requires that separate account be opened for every client of a Participant and Rule 59 for similar requirement on Broker Dealers.

¹⁷Section 198 ISA.

member firm or any of its directors, officers, employees or representatives in relation to securities, money or any property entrusted to or received or deemed received by the dealing member firm in the course of its business as a capital market operator.¹⁷

A careful consideration of the provisions above leaves no one in doubt that the intention of the Act is to compensate investors for losses where they fail to obtain adequate remedy on insolvency of a capital market operator or intermediary. Even then, one must be careful not to misinterpret the provisions as all that is intended is "mitigation of losses suffered by investor" without more. No assurance or guarantee is made for full satisfaction of investors' claims. This therefore means that the investor ought to do everything possible to ensure that he obtains as much remedy as possible in an insolvency proceeding against the intermediary.

Given these implications on investors, one would expect that the SEC would make provisions for distributions of assets on insolvency of a securities intermediary. However, save for the provision on Investor Protection Fund, which in itself gives no assurance of complete satisfaction, nothing in the Rules or ISA suggests that the regulator gave any thought to the hardships that could occur where the investor is unable to obtain full satisfaction of its claims against the intermediary.

Thus, even though an investor would ordinarily enjoy contractual rights of a personal nature against direct intermediaries in the form of re-delivery of assets, a prudent investor would need to reserve proprietary and beneficial interests in the assets held by the intermediary in order to insulate it from claims of the creditors of the intermediary.

Where the relevant security is in a bearer form such as promissory notes, this can simply be achieved by creating a bailment relationship¹⁸. This is possible because possession can validly be transferred to the

intermediary under the English common law in relation to the tangible asset comprised in the promissory note. However, where the relevant security is in a dematerialized form, the only way to ensure that the assets of the investor are treated separately in the event of insolvency of the intermediary is to create a trust. Such a trust will enable the intermediary obtain title in the intangible assets comprised in the book entry records of the intermediary, which by law are incapable of possession and cannot be transferred by bailment.

Now, the problem with creating a trust relationship is that the trustee investor merely retains an equitable interest which is ranked behind legal interests in the event of insolvency of the intermediary; such that where the intermediary misapplied the assets or has insufficient assets to settle the claims of its creditors on insolvency, the investor may be pushed further down the line of creditors slated to share in the assets of the intermediary.

Where the relevant intermediary is a bank, the Banks and Other Financial institutions Act (BOFIA)¹⁹ and the Nigerian Deposit Insurance Corporation Act 2006 (NDIC) would ordinarily regulate priority of distributions in the event of insolvency. With regards to priority of distributions, BOFIA only provides for priority of deposit liabilities of the insolvent bank over all other liabilities of the bank. The problem, therefore, is to determine the nature of investor's rights in the intermediary. One question that readily springs to mind in consideration of the nature of the investor's rights is whether Nigerian courts would perceive an investor as a debtor of the bank capable of being ranked alongside depositors on the intermediary bank's insolvency? No doubt Nigerian

courts will find it difficult to rank such investors alongside depositors of an insolvent bank, given that the primary legislative intent behind BOFIA is for depositor protection.²⁰ Assuming, however, that a court agrees to rank such investors alongside depositors, it is doubtful that the NDIC provision which guarantees payment to depositors only up to a maximum of N200, 000 will provide any comfort to investors with huge exposures in the capital market.²¹

Where the courts fail to perceive these investors as capable of being ranked alongside depositors, it is likely that the general corporate law would provide the statutory platform for resolution of investor's claim on insolvency of the intermediary. Part XV of CAMA provides for winding up of companies and regulates priority of distributions on the insolvency of a company. One difficulty with this scenario, however, is that CAMA does not recognize securities in dematerialized form. As earlier noted, registration of securities in the name of the relevant investor is required for recognition of interests in shares. Furthermore, only a certificate in the name of the member serves a prima facie evidence of title in shares. It is, therefore, difficult to see how a court in Nigeria would make a determination for distribution of such assets in the event of insolvency of the intermediary without rendering the claim invalid. Even assuming, however, that a court in Nigeria finds that such an investor is capable of receiving assets under CAMA in relation to the dematerialized securities, it is likely that the equitable trust relationship between the investor and intermediary would cause the investor to be ranked least in priority alongside other general creditors of the intermediary. Thus, the investor stands to suffer severe hardship

¹⁸See for instance Rule 148 of the Consolidated Rules which confers the status of a bailee on the custodian of assets held on behalf of an investor.

¹⁹Cap. B 3 Laws of the Federation of Nigeria 2004.

²⁰With "deposit" defined strictly in section 66 of BOFIA as

money lodged with any person whether or not for the purpose of interest or dividend and whether or not such money is repayable upon demand upon a given period of notice or upon a fixed date.

²¹Section 20(1) NDIC Act.

²²Article 14(2).

unless steps are taken to reform the Nigerian corporate law to accommodate the innovations made in relation to securities holding in the capital market. Alternatively, regulators can sponsor insolvency legislation before the Nigerian National Assembly in order to ensure protection of investors' interests in the capital market.

UNIDROIT Convention

The UNIDROIT Convention provides the substantive framework for dealing with securities held by intermediaries in transnational jurisdictions. The Convention acknowledges that individual states have the power to regulate, supervise and oversee the holding and disposition of intermediates securities, but only to the extent that the exercise of such powers do not contravene the provisions of the Convention. It preserves the prerogative of a contracting state's substantive and procedural rule of law to apply in insolvency proceedings, such as rules relating to: a) the ranking of categories of claims; b) avoidance of a transaction as a preference or a transfer in fraud of creditors; or c) the enforcement of rights to property that is under the control and supervision of the insolvency administrator.²² This means that in the absence of substantive or procedural rule of law provision in a contracting state, the rights and interests of parties in insolvency proceeding could be determined in accordance with the Convention.

The Convention determines priorities between competing security interests arising at the same level of intermediary in Articles 19 and 20.²³ However, the general priority regime is subject to domestic rules of priority relating to non-consensual security.²⁴ Parties may by agreement vary the priority of distributions in Article 19 as

²³For a fuller understanding, read comprehensively the provisions of Article 11 and 12.

²⁴Article 19(5); Non-consensual security in the Nigerian situation would include charges.

²⁵Article 19(6).

between themselves, but such an agreement will not affect the rights of third parties.²⁵

A comprehensive reading of the provisions of the Convention establishes the very important principle, which is that effectiveness in the insolvency of a relevant intermediary impacts on the integrity of the intermediated holding system and by implication the relevant capital market, hence the need for a comprehensive insolvency regime.

Conclusion

This newsletter has sought to show the lacuna existing in the law relating to insolvency of an intermediary, especially in view of the Rules of SEC which has made it possible for securities to be held in dematerialized form contrary to the provisions of CAMA. It is important to realize that SEC has made commendable efforts to bring the Nigerian capital market up to speed with other world class markets and to encourage foreign investor participation. However, failure to adequately manage the regime applicable to insolvency of intermediaries in Nigeria by way of amendment of obsolete provisions or enactment of comprehensive insolvency legislation would make nonsense of the achievements within the capital market. Such an anomaly would make it possible for creditors of an intermediary to have access to property properly placed in the custody of the intermediary before the beneficial owner investor can be allowed to recover his own assets. This would erode domestic and foreign investor confidence in the market and hamper the integrity of the fledgling intermediary holding system in Nigeria.

Therefore, urgent steps are required to create an insolvency regime that would enhance the integrity of the Nigerian capital market.

THE FUTURE OF NIGERIA BANKING SYSTEM: SEPARATE STRUCTURES AND HOLDING COMPANY ARRANGEMENT



Abstract

The Central Bank of Nigeria (CBN) recently reviewed the universal banking model in favour of separate banking licenses under the Banks and Financial Institutions Act (BOFIA).¹ The Regulations² require banks to divest from all non-banking businesses and obtain fresh licenses to operate as commercial, merchant, specialized or development banks. This newsletter examines some of the issues surrounding the recent regulatory requirement.

Background

The Universal Banking (UB) model adopted in 2001 allowed Nigerian banks to diversify into non-banking businesses, as against the banking businesses specified under BOFIA, including the business of receiving deposits or current account, savings account or other similar account, paying or collecting cheque drawn by or paid in by customers, provision of finance or such other business as the Governor of CBN may, by order published in the Gazette, designate as banking business.³ However, banks did not immediately diversify until the post-consolidation exercise in 2005 when they experienced significant boost in their capital, causing the big banks to diversify into non-

¹Cap B 3 Laws of the Federation 2004

²CBN Regulation Nos. 1, 2 & 3, 2010

³Section 66 BOFIA

banking businesses, including insurance, stock broking and other proprietary trading in capital markets. The UB model currently practiced in Germany represents a structural form of integration where banks combine commercial and investment banking within a single corporation but conduct other financial activities through separately capitalized subsidiaries owned by the universal bank. The German grossbanken (“big banks”), including Deutsche Bank and Commerzbank are organized in this way as are many regional banks.⁴

The CBN Governor, Mallam Sanusi Lamido Sanusi, in a recent address titled “Reform of the Nigerian Banking System”⁵ announced a new model under which banks would no longer be allowed to invest in non-bank businesses. He said that banks wishing to continue with such investment would be required to divest or spin-off the businesses to holding company that will be licensed by the CBN as other financial institution. This followed an earlier speech⁶ where the Governor announced CBN's proposal to adopt the “Volcker Rule” or some version of Glass-Steagall in the Nigerian banking industry. These represent present and past banking regulations in the United States of America (US). The US Banking Act of 1933 (also known as the Glass-Steagall Act) separated commercial and investment banking. It prohibited commercial banks from engaging in brokerage, insurance, real estate and most underwriting activities. It also prohibited investment banks and insurance companies from engaging in commercial banking activities. The reasoning behind the Glass-Steagall Act was the widely-held belief, at the time, that the US bank failures of 1930-1933

resulted from the risks banks took in the stock market. Thus, the Act effectively erected a wall between commercial and investment banking.

The “Volcker Rule”⁷ on the other hand is a recent promulgation in the US in response to the global crisis and makes improvements to regulation of banks and savings associations holding companies and depository institutions. It prohibits insured depository institutions from engaging in proprietary trading; or acquiring or retaining any equity, partnership or other ownership interests in or sponsoring hedge funds or private equity funds. Section 619 of the Dodd-Frank Act (to be codified at 12 U.S.C section 1851(h)(4)) defines “Proprietary trading” as engaging as a principal for the trading account of a banking entity or supervised non-bank financial company in any transaction to purchase or sell, or otherwise acquire or dispose of, any security, any derivative, any contract of sale of a commodity for future delivery, any option on any such security, derivative, or contract, or any other security or financial instrument that the appropriate Federal banking agencies, the Securities and Exchange Commission and the Commodity Futures Trading Commission (US Regulators) may, by rule as provided in subsection (b)(2) determine.” This means that the types of investments which the Volcker Rule prohibits are those made for the “trading accounts” of a banking entity or supervised non-bank financial entity. Even then, the scope of the “trading account” is limited to cover only “near term” transactions or transactions that involve “short-term price movement.”⁸ The Act however permits US Regulators to expand the scope of definition of “trading account” whenever they deem it necessary.

⁴See www.oecd.org for *Harold D. Skipper, Jr*; Financial Services Integration Worldwide: Promises and Pitfalls.

⁵See www.cenbank.org for Keynote Address on Reforms in the Nigerian Banking System; September 23, 2010.

⁶See www.cenbank.org for “The Nigerian Banking Industry: what went wrong and the way forward” delivered at a Convocation at Bayero University, Kano on February 26, 2010; Page 17.

⁷Implemented by Title VI of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) and named after former Federal Reserve Board Chairman, Paul Volcker.

⁸See www.skadden.com for “Skadden Commentary on the Dodd-Frank Act”; July 9 2010

Recent CBN Regulations

The CBN recently released Licensing Regulations⁹ to back its policy statements, which effectively repealed the UB guidelines in favour of licenses permissible under BOFIA. These Regulations require Nigerian banks to restructure as:

- a) solely commercial banks,¹⁰ in which case they would be required to operate as:
 - i) Regional banks within a minimum of six or maximum of twelve contiguous states in Nigeria and not more than two Geo-Political Zones, as well as within the Federal Capital Territory (FCT Abuja). "Geo-Political Zones" means the geo-political grouping of states constituting the Federal Republic of Nigeria, including North Central Zone, North East Zone, North West Zone, South East Zone, South West Zone and South South Zone;
 - ii) National banks with operations within every state of Nigeria; or
 - iii) International banks with operation in every state, as well as offshore operations in any country of choice with the approval of CBN.

"Permitted Activities" for such commercial banks are specified in section 3 of the Regulation. Most importantly, however, these commercial banks are prohibited from engaging in the following activities:

- i) Insurance underwriting
- ii) Loss adjusting
- iii) Re-insurance
- iv) Asset management
- v) Issuing house and capital market underwriting services
- vi) Investment in equity and hybrid-equity instruments save and except for those

⁹www.cenbank.org

¹⁰Regulation No. 1, 2010

- investments permissible under BOFIA
- vii) Proprietary trading, save as permitted by the Regulation
- viii) Provision of financial advisory services other than in accordance with the provisions of section 3(h) of the Regulation; and
- ix) Any other business activities that may be restricted by CBN from time to time.

b) Nigerian banks may also restructure solely as merchant banks. These banks are required to undertake most of the activities prohibited from commercial banks.¹¹ They are, however, prohibited from accepting deposit withdrawals by cheque, granting retail loans or engaging in any form of retail banking, holding equity interest acquired in a company for more than six months while managing an equity issue and providing insurance underwriting services, loss adjusting, re-insurance or other related insurance activities.¹²

c) A third category of banks permitted under the Regulations¹³ are classified as specialized institutions, including non-interest banks (regional and national), primary mortgage institutions, microfinance banks, development banks and discount Houses.

These Regulations seem to support the pronouncement of the Governor of CBN relating to the intention of CBN to restructure Nigerian banking industry in line with the "Volcker Rule" or some

¹¹Section 3 Regulation No. 2, 2010

¹²Section 4 Regulation No.2, 2010

¹³Regulation No. 3, 2010

version of "Glass-Steagall." It would appear that, just like the Volcker Rule, the Regulation¹⁵ permits trading transactions in government securities and on behalf of customers. However, while the Volcker Rule specifically allows deposit institutions to engage in underwriting and market-making transactions, to the extent that they do not exceed near term demands of clients, customers, or counterparties,¹⁵ the CBN Regulation for deposit institutions categorically prohibits underwriting (insurance, issuing houses and capital market underwriting services). Furthermore, Volcker Rule permits certain risk-mitigating hedging for insured depository institution's holdings, and investments in small business investment companies, public welfare, and qualified rehabilitation expenditures.¹⁶ Most of these seem to have been prohibited by the CBN. In addition, while the Volcker Rule makes provisions for US Regulators to permit additional activities to the extent that they promote and protect the reliability of banking organizations as well as the financial stability of the US, CBN's Regulations appear to have placed a cap on permitted activities.

Nigerian banks are required to submit plans of ensuring compliance with CBN Regulations no later than ninety days from 4 October 2010 (when the Regulations became effective). Volcker Rule, on the other hand, would only become effective upon the earlier of two years after its enactment or 12 months after the issuance of final rules. Even after the Rule becomes operative, banking organizations would be given additional two years within which to divest or discontinue prohibited activities.¹⁷ The Rule permits US Regulators to grant specific one year extensions for up to three additional years to enable required transitions and wind down¹⁸. Where there are

outstanding contractual obligations, Volcker Rule empowers the Board of Governors of the Federal Reserve System to grant a banking organization a single extension of up to five years to take or retain its ownership interest in, or provide additional capital to, "illiquid funds," during which time the organization would be allowed to make additional investments in illiquid funds pursuant to its contractual obligations.¹⁹ The wordings of CBN Regulations seem to suggest full compliance (from an uncertain date), notwithstanding any contractual obligations. Therefore, where Nigerian banking institutions fail to draft their planned divestment to accommodate outstanding contracts, they may be exposed to litigations notwithstanding that the divestments were made in compliance with regulatory requirements.

In his key note address of September 2010, the Governor of CBN also stated that banks wishing to continue with their non-bank investments would be required to "spin-off" their businesses to holding companies that would be licensed by the CBN as other financial institutions. It would appear that by this pronouncement the CBN has allowed a "holding company structure" in the Nigerian banking industry. It is therefore necessary to briefly examine the "bank holding company model" practiced in other jurisdictions, for instance the US.

Holding Company Arrangement

The meaning of "holding company" in Nigeria can be gleaned from the definition of the term "subsidiary" in section 338(1) of the Companies and Allied Matters Act (CAMA).²⁰ The section defines a company as a subsidiary of another if:

- a) the latter company
 - i) is a member and controls the composition of its board of directors; or

¹⁴Regulation No. 1, 2010

¹⁵See www.skadden.com for "Skadden Commentary on the Dodd-Frank Act"; *ibid*

¹⁶*ibid*

¹⁷*ibid*

¹⁸*ibid*

¹⁹*ibid*

²⁰Cap C20 Laws of the Federation of Nigeria, 2004

- ii) holds more than half in nominal value of its equity share capital; or
- b) it is a subsidiary of another company which is the company's subsidiary.

The expression is given further elucidation in subsection (5)²¹ where the Act states that “a company shall be deemed to be the holding company of the other if the other is its subsidiary.”

The US adopts Bank Holding Company (BHC or US BHC) arrangement; typically, this involves an arrangement where a non-operational company owns all the shares in separately incorporated and capitalized sectoral subsidiaries. The Bank Holding Company Act of 1956 was the first legislation to regulate Bank Holding Companies (BHCs) in the US. It defines a “BHC” as any company which has control over any bank or over any company that is or becomes a BHC by virtue of the Act.²² A company is said to have control of another if:

- a) the company directly or indirectly or acting through one or more persons owns, controls or has power to vote 25 percentum or more of any class of voting securities of the bank or company;
- b) the company controls in any manner the election of a majority of directors or trustees of the bank or company; or
- c) the Board of the Federal Reserve System determines, after notice and opportunity for hearing, that the company directly or indirectly exercises a controlling influence over the management or policies of the bank or company²³.

²¹Section 338 CAMA

²²Section 2(a)(1)

²³The Bank Holding Company Act 1956; section 2(a)(2)

A US BHC may engage in banking and non-banking investments (mortgage banking, consumer and commercial finance and loan servicing, leasing, collection agency, asset management, trust company, real estate appraisal, financial and investment advisory activities, management consulting, employee benefits consulting, career counseling services and certain insurance-related activities). A BHC can also make investments in companies engaged in activities that are not closely related to banking, but these investments must not exceed 5 percent of the target company's voting stock. While the US Securities and Exchange Commission and the Federal Deposit Insurance Corporation (FDIC) regulate federal depository institutions, BHCs are regulated by the Federal Reserve System. In spite of the extent of permitted activities, US banks remained largely segregated under the Bank Holding Company Act until the Gramm-Leach Bliley Act of 1999 (also known as the Financial Services Modernization Act), which allowed BHCs to declare as Financial Holding Companies (FHCs). These companies were allowed to engage in financial activities, including securities underwriting and dealing, insurance agency and insurance underwriting activities, and merchant banking activities. The Financial Services Modernization Act granted FHC, a hybrid form of BHC, additional authority to make financial investments. The combination of the Glass-Steagall Act and Gramm-Leach Bliley Act, however, limited the ability of BHCs to engage in commercial, insurance, and other non-bank financial activities.

What the Volcker Rule has now done, is prohibit depository institutions (most of which constitute subsidiaries of BHCs) from engaging in the proprietary trading activities defined above.²⁴

BHC structures are known to have some advantages, one of which is the cost effect the group enjoys,

²⁴See also section 619 of the Dodd-Frank Act.

mainly from scope of production and operational efficiencies. BHC structure allows corporations to engage in multiple activities which they would, otherwise, have been unable to engage in if they were acting in separate capacities, allowing affiliates to leverage on the success of other parts of the enterprise. BHCs' engagement in greater product range may enhance their earning potential and thus, increase profit. Similarly, a holding company arrangement may result in consolidated tax arrangement requiring contribution from all the companies within the group, and this may ultimately create some tax advantage to the group. However, depending on the jurisdiction, the holding company must own a certain level of stock, usually between 50-80 percent, to be able to file a consolidated tax return. A significant disadvantage occurs where separate tax returns are required to be filed for the parent company and the subsidiary(s), and where inter-corporate dividends are subject to additional tax. In spite of these advantages, the holding company arrangement also has a number of weaknesses. The holding company may make unsound loan or risky investment to an affiliate, which could jeopardize the financial resources it has to support other subsidiaries. Furthermore, it is not always possible to insulate banks from holding company problems. Situations may arise where the holding company may be financially exposed, and thus place pressure on the subsidiaries to engage in risky investments.

Going by its recent pronouncements, it appears that the CBN has adopted a version of the Glass-Steagall Act on the one hand, thus completely separating commercial banks from investment banks and other specialized institutions. On the other hand, it creates a BHC arrangement in Nigeria. What is unclear, however, is whether these BHCs will be allowed to undertake the full complement of services that BHCs were allowed to undertake in the US. It would appear from CBN's pronouncements that Nigerian BHCs would be allowed to own insurance, asset management and other investment banking

subsidiaries, such that affiliates of depository institutions could engage in the non-bank activities prohibited under CBN Regulations. Under this arrangement, banks have the choice of moving certain activities that were previously conducted in-house, or in a subsidiary of the bank, to an affiliate outside of the bank.

Furthermore, it is clear that Nigerian BHCs would be regulated as other financial institutions; however, the nature of relationship between the holding company and companies comprised under it, and between banks and non-bank affiliates remains unclear. For instance, it is unclear whether a non-operating holding company option is allowed or whether holding companies are required to be operating companies. There is also no legal or regulatory framework to insulate banks from financial problems that might occur in the holding company affiliates of the banks, such as "firewall provisions" to regulate bank lending to holding company affiliates, requirements that transactions with affiliates be on market terms, and provisions that would prevent holding companies from extracting excessive dividends from banks enough to deplete banks' capital. Presently, the framework for operating BHCs in Nigeria seems to be hugely inadequate with significant cost implications for restructuring that are yet to be addressed; this could explain why majority of banks in Nigeria have chosen to divest their interests and restructure their operations to fit into the categories (commercial, merchant and specialized banks) specified by the CBN.

If reports in the media are anything to go by,²⁵ it would appear that Nigerian BHCs are required to be non-operating. It might also be safe to assume that the BHCs are required to adopt the form specified in section 338 of CAMA. This would mean that banks held as subsidiaries of the holding company must be de jure controlled by the parent holding company.

²⁵ www.vanguardngr.com

That is, the parent must own a majority of the bank's shares. The difficulty would then be the criteria to adopt in determining the remaining shareholding. Since no other indication is given, it would also appear that the other financial institutions affiliates of the bank must also be de jure controlled by the parent holding company in line with CAMA. Furthermore, it would appear that the parent holding company and its downstream holdings will be subject to consolidated supervision with a risk-based focus. This means that supervision will focus on those activities of the group that may pose material risks to the bank and other regulated financial institutions which form part of it. However, it is unclear whether the holding company group will be subject to consolidated capital adequacy requirement or whether the parent holding company and respective subsidiaries will be subject to capital requirements as prescribed by the CBN in line with their nature of business. The latter appears to be the most logical option, as consolidated capital adequacy requirement may expose banks to greater risks.

Conclusion

Media reports suggest that because of the perceived difficulties and complications associated with adopting the holding company arrangement, Nigerian banks are currently interested in divesting their non-bank subsidiaries and re-structuring their operations to form commercial, merchant banks and other specialized institutions as required by the CBN.²⁶ This may not continue, as some may subsequently decide to form BHCs; there are reports that First Bank and Skye Bank plan to adopt the holding company option.²⁷ Without adequate legal and regulatory frameworks, such arrangement may pose significant difficulties and create complications within the Nigerian banking and financial system. There is, therefore, the need to provide appropriate

frameworks for a BHC arrangement. Only a proper definition of the holding company model, ownership structure and nature of operation, as well as relationship with the stand-alone model, would ensure stability within the system.

²⁶Ibid

²⁷Ibid

The New CBN Cash-less Policy: An Overview

INTRODUCTION

In line with global trends, the Central Bank of Nigeria ("CBN") in 2011 introduced a Cash-less Policy (the "Policy") to the Nigerian economy. This Policy which aims at reducing the amount of physical cash circulating in the economy whilst encouraging the use of alternative electronic products and channels for financial transactions is already operational in Lagos State and set to take off in other major parts of the country by June 1, 2012. The choice of Lagos state as the starting point is explicable given that 65% of commercial transactions in the country take place in the State¹.

The Policy, which has been endorsed by the Bankers Committee,² pegs the daily limit for withdrawal and lodgment of cash in deposit money banks at N150, 000 and N1, 000,000 for individuals and corporate bodies respectively. Where individuals and corporate bodies choose to withdraw or lodge more than the set limit, cash handling charges would be incurred.

According to the apex body, the Policy became necessary to discourage the high usage of cash across the economy

¹ Nigeria: As trial cash-lite policy begins in Lagos Available at www.sunnewsonline.com/.../2012/.../editorial-04-01-2012-001.html - last assessed on 24/02/2012

² Bankers Committee comprises of the CBN, the Nigeria Deposit



which (C) AINA BLANKSON LP 2012 has a number of negative consequences including high cost of cash. In 2009, the direct cost of cash management to the banking industry was set at N114.5billion, and may be as high as N192billion in 2012³. This spiraling cost of cash management, most of which is passed onto the consumer in the form of bank charges and lending rates, is as a result of the cash dominant economy existing in Nigeria. For example, Currency-In-Circulation ("CIC") rose by a 20.36% increase from December 2008 to N1.184 trillion in December 2009⁴. As at December 31, 2010 the total CIC value stood at N1.378 trillion, showing an increase of 16%⁵. Further reports show that about 90% of daily withdrawals by bank customers are below N150, 000, thus, only about 10% of bank customers are responsible for the heavy cost of cash management borne by all bank customers⁶.

Furthermore, the present levels of cost and inefficiencies in providing banking services and the poor quality of services experienced by the majority of the banking public is set to be addressed by the new Policy⁷. This is in view of the fact that customers would have several electronic alternatives for carrying out transactions and thus would avoid dealing with the banks inefficiencies on a regular face to face basis.

The Policy will also curb an informal economy where the effectiveness of monetary policy tailored at managing inflation and encouraging economic growth is limited. According to the CBN data, unbanked money in the informal sector is estimated at N1.2 trillion, coupled with the fact that about 74% of the adult Nigerian population do not operate any

form of banking services, while 85% of adult females have never operated banking services⁸. On the other hand, 61% of those without bank accounts would prefer to have one, according to the CBN data⁹. Mobile money is the easiest way to win these accounts. In addition, given that an efficient and modern payment system is positively correlated with economic development, this Policy would be a key enabler for economic growth. Thus, this newsletter examines the provisions of the New CBN Cash-less Policy, its relevance to electronic commerce development in Nigeria, as well as factors that would hinder its effectiveness. The newsletter also examines the mobile money practice in Kenya.

HIGHLIGHTS OF THE POLICY

Some of the highlights of the Policy include its implementation in Lagos from January 1, 2012¹⁰ and June 1, 2012 in other parts of the country such as Abuja, Kano, Porthacourt and Aba amongst others outlined below.

Limits

The Policy provides that from March 30, 2012 in Lagos and June 1, 2012 in other parts of the country, a daily cumulative limit of N150,000 and N1,000,000 on free cash withdrawals and lodgments by individual and corporate customers respectively shall be imposed. Where individuals and corporate organizations carry out cash transactions above the limits, charges would be incurred. By this, banks are authorized to deduct N100 for every N1,000 above N150,000 transacted by individual customers, and N200 per N1,000 above the N1 million limit transacted by their corporate customers. The

Insurance Corporation (NDIC), Discount Houses and the 24 commercial banks.

³ Tunde Lemo: Press Statement on the New CBN Cash Collection Policy. Available at <http://www.cenbank.org/Out/2011/pressrelease/gvd> last assessed on 26/02./2012

⁴ Ibid

⁵ Ibid

⁶ Ibid

⁷ Ibid

⁸ John Omachonu: Enhancing Cashless economy through mobile banking. Available at

http://www.businessdayonline.com/New/index.php?option=com_content&view=article&id=32988:enhancing-cashless-economy-through-mobile-banking&catid=54:banking-finance&Itemid=522.last assessed on 26/02/2012.

⁹ Ibid

¹⁰ Sanctions will be applicable from March 30, 2012 in Lagos and June 1, 2012 in other parts of the Country.

contravention of this provision by the Bank shall attract a fine of five (5) times the amount that the bank waives as a first offender and subsequently, the bank shall pay ten (10) times the charges waived¹¹.

It is imperative to note that the limit is set to apply to the account irrespective of the channel by which the cash was either withdrawn or deposited. Thus withdrawals or deposits made from over the counter, ATM and 3rd party cheques encashed over the counter all make up the cumulative limit. Furthermore, the limit applies to cash brought through Cash-in-Transit (CIT) companies, as the CIT companies only serve as a means of transportation.

Account Application

The Policy applies to all accounts, including collection accounts. Banks are therefore required to work with their corporate customers to arrange for suitable e-collection options.

Cash Pick Up and Lodgment Services

The Policy provides that only CBN CIT licensed companies shall be allowed to provide cash pick-up services. Furthermore, banks are to cease CIT lodgment services rendered to merchant-customers in Lagos State from January 1, 2012 and in other parts of the country by June 1, 2012. Any Bank that continues to offer CIT lodgment services to merchants shall incur a fine of N1 million per movement¹².

Third Party Cheques

Under the Policy, third party cheques above the sum of N150, 000 shall not be eligible for encashment over the counter. Rather value for such cheques shall be received through the clearing house. Thus any cheque issued with a value above N150, 000 (C) AINA BLANKSON LP 2012 to a third party can only be deposited into an account, as such cheques cannot be cashed. If a bank allows 3rd party cheque

encashment, it shall be liable to a sanction of 10% of the face value of the cheque or N100, 000 whichever is higher¹³.

Service Charges

The Policy provides that service charges will not apply until March 30, 2012 in Lagos and June 1, 2012 in other parts of the Country. This will avail people the time to migrate to electronic channels and utilize the infrastructure that has been put in place. The service charge for daily withdrawals above the limit into an account shall be borne by the account holder. It is also imperative to mention that the charges are levied on the amount above the limit. For example, where an individual withdraws N250, 000 from the ATM, the service charge will apply on N100, 000 - the amount above the daily limit.

Interstate Transactions

The Policy provides that charges shall apply for all transactions in Lagos, and on Lagos State based accounts. It is however pertinent to note that where a transaction is initiated out of Lagos State, and affects a Lagos based account, such account shall not attract charges and shall not be counted as part of the daily cumulative amount on that account. This is in view of the fact that the Policy has not been activated outside Lagos.

For example, where a deposit above the limit is made from Ondo state into a Lagos state account, such account shall not attract charges. On the other hand, where a transaction is initiated from Lagos State and affects an account outside Lagos, such account shall attract charges where the said transaction is above the limit, given that the policy has been initiated in Lagos. For example, where a deposit is made from Lagos State above the limit, into an account in Abuja, the depositor shall pay the related charges, while the account into which it is paid outside Lagos shall not be impacted. It should be noted that the Policy does not prohibit withdrawals or deposits above the

¹¹ CBN Circular on Industry Policy on Retail Cash Collection and Lodgement (IITP/C/001) Ref: COD/DIR/GEN/CIT/05/031.

¹² Ibid

¹³ Ibid

stipulated amounts, but such transactions will be subject to cash handling charges.

PROJECTED BENEFITS- E-PAYMENT SYSTEM

The benefits of this Policy are endless. For one, it will open up the Nigerian economy to increased acceptance of electronic payment (e-payment) systems and channels, which would ultimately move Nigeria to a cashless economy in the 21st century. The Policy will also benefit different stakeholders in diverse ways. For the government, it would aid adequate budgeting and taxation, as transactions via electronic systems will leave traces that will enable the government bring more people into the tax web than is currently available¹⁴. For banks, the introduction of mobile money technology for instance will encourage large customer coverage. Successful implementation of the Policy will also reduce the cost of operations for banks. For consumers, the policy will lead to increased convenience as well as a variety of service options. Most importantly however, the Policy will promote cross border trade and reduce crime.

E-payment is a subset of electronic commerce (e-commerce) that enables parties to effect financial transactions electronically. The most common forms of e-payments in use across countries today include cards,¹⁵ internet (online) payments,¹⁶ and mobile payments.¹⁷ E-payments have a number of advantages which may include privacy and time management. E-payments tend to reduce the amount of time spent on bill management or payment by a great deal of percentage as it enables customers pay bills or make other payments in a

flash. Perhaps, the greatest advantage of e-payment, however, is convenience. Individuals can pay bills or make purchases at any location 24 hours a day, 7 days a week.

However, to take advantage of this mode of transaction and encourage individuals to adopt the e-payment system, Nigerian regulators may need to do more than implement a policy limiting the amount of cash deposits or withdrawals. They may need to adopt measures to ensure secure online transactions. Similarly, the government would need to implement comprehensive e-commerce legislation. In countries where the e-payment system is fully operational, governments have implemented e-commerce regulations and legislation which are frequently amended and standardized to take care of new innovations. For instance, the United States implemented e-commerce legislation such as the Uniform Electronic Transactions Act of 1999 and the Electronic Signatures in Global and National Commerce Act of 2000 to encourage e-commerce transactions. The European Union also implemented the E-Commerce Directive¹⁸ and E-Signature Directive¹⁹.

National governments adopting the e-commerce trend also strive to improve the infrastructural needs of their institutions by promoting the development of necessary technologies, expanding high-speed information network, and sponsoring training and awareness programs to aid acceptability among the populace.

THE CHALLENGES OF THE POLICY

Attractive as the Policy has been made to appear, several challenges which may affect its effectiveness are as follows:

¹⁴ Cash-lite policy will increase tax administration's efficiency – Expert available at <http://www.ppiguideonline.com/finance/cash-lite-policy-will-increase-tax-administration%E2%80%99s-efficiency-%E2%80%93-expert/> last assessed on 22/02/2012

¹⁵ Such as credit cards, debit cards and prepaid cards.

¹⁶ This involves transferring money or making purchases via the internet.

¹⁷ Consumers use mobile phones for a variety of electronic transactions, including online payments.

¹⁸ Directive 2000/31/EC on Certain Legal Aspects of Information Society Services, in particular Electronic Commerce, in the Internal Market (Directive on electronic Commerce).

¹⁹ Directive 1999/93/EC on a Community Framework for Electronic Signatures.

Infrastructural Deficit:

The gaps in infrastructure pose a huge challenge to the achievement of the Policy. The level at which the country's power sector is at right now does not indicate that it can support a cash-less system. Nigeria's power system is quite irregular and steady power supply is key in achieving the Policy. Thus, power must be improved dramatically to accommodate smooth operations of financial activities. It is worthy to note that the banks are collaborating to participate in the CBN initiative of Shared Services, in order to share and lower infrastructure costs, which will go a long way in enhancing infrastructure.

Inadequate POS Systems

The effective operation of the Policy is partly hinged on the availability of adequate Point of Sale (POS) machines. The proposed deployment by the CBN of an estimated 40,000 POS terminals expected to complement existing e-payment channels in the country was not achieved before the official launch of the scheme in Lagos due to tariff bottlenecks encountered with the Nigeria Customs Service late last year²⁰. Furthermore, POS are occasionally fraught with technical hitches caused by erratic internet connectivity as well as epileptic power supply.

Another challenge to the success of the Policy is the current level of awareness. The knowledge base needed for the success of the policy is not yet anything near what should allow for the implementation of the Policy. An average person in Lagos is yet to have a total grasp of the Policy, yet the implementation has already commenced in the state. There is a need for increased knowledge, skills and capabilities acquired through education and training of labour force in the financial institutions. The CBN in collaboration with the Banks need to

continue to educate and sensitize the masses on the benefits of e-payments as a modern, secure and efficient means of transaction.

Legal Security

Security is a key determinant in the success of the Policy as it builds the confidence of users. A legal framework for the e-payment system is essential for creating a certain and reliable environment for economic agents and ensuring the system functions adequately. The e-payment system involves the use of electronic means whose legal validity and mandatory effects must be clearly defined and consequently requires a sound and efficient legal framework that allows its implementation and use under conditions of legal security. Under the new Evidence Act 2011 (the "Act"), electronic evidences are now acceptable in court. This would address some of the challenges in civil and criminal cases as they relate to admissibility of electronic evidence which will relate to the Policy but that is not all that is needed. The development of the Policy should be hinged on governing laws and regulations aimed at enhancing and not just regulating the system. Furthermore, the legal framework should take into consideration transaction security in view of the problem of porous web pages, and the vulnerability of confidential information to hackers. MOBILE MONEY- KENYA It is interesting that Africa boasts of the world's most successful mobile payment system even though mobile money was first introduced in the Philippines in 2001.

In 2007, Kenya pioneered the banking business with the introduction of M-Pesa²¹, the mobile money-transfer service that revolutionized banking. The M-Pesa is a joint venture between Vodafone and Kenyan's Safaricom. To use this service, customers are required to first register with Safaricom at an M-Pesa outlet, usually a shop, chemist or petrol station.

²⁰ Mayor Iroko: Cashless Lagos: False Start to a Good Policy Available at <http://www.zimbio.com/Nigeria+Today/articles/AYnZHMT7INu> last assessed on 26/02/2012

²¹ Pesa means money in Swahili, thus M-pesa means Mobile Money.

Thereafter, they can load money on their phone which can then be sent to third parties via text message. The recipient then takes the phone to the nearest vendor, where the cash can be picked up. The transactions occur instantaneously, and most of the time the money stays in the account less than a week.

The M-Pesa has transformed Kenya's entire economic system by bringing millions of previously "unbanked" Kenyans to the formal banking sector. About USD\$11.5 billion dollars has passed through the service since its launch accounting for 25% of the country's GNP²². Its pervasiveness and wide acceptance has made Safaricom the biggest mobile money operator in East Africa.

Today, the service provides mobile banking facilities to more than 70% of the country's adult population who use their mobile phones to pay taxi fares, wages of field workers, utility bills, get money out of ATMs without owning an ATM card or a traditional bank account. The M-Pesa continues to be (C) AINA BLANKSON LP 2012 the most successful mobile money deployment globally, with over 700 million domestic and international money transfer transactions, accounting for \$130 million revenues in 2010²³.

Across Africa, mobile banking is projected to become a \$22 billion industry by 2015, buoyed by soaring cell-phone use and growing financial services demand according to Juniper Research, a consultancy outfit²⁴. Correspondingly, mobile network operators will earn \$7.8 billion in direct and

indirect revenues from serving a projected 364 million low income, unbanked people in about 147 countries who are projected to use financial services by 2012²⁵. CONCLUSION As the world gradually migrates into a global village, the need for Cash-less Policy cannot be undermined. Its benefits are very much compelling, however, commitments in relation to legal framework, and investments must be sustained.

The CBN must be ready to invest heavily in order to achieve the objectives of the Policy. Technology is not cheap and it is ever evolving at a very fast pace. Thus investments would need to be made in infrastructure, training, marketing, security, and maintaining its networks on a yearly basis.

Furthermore, as it relates to laws that are needed to enforce new methods of transactions and a changing culture, the CBN must partner and work with the National Assembly to ensure that appropriate legislation, such as e-commerce legislation are introduced. Changes will need to be made in relation to enforcements of new legislation by the CBN and all other executive arms of government that are empowered such as the Economic and Financial Crimes Commission, the Independent Corrupt Practices and Other Related Offences Commission, as well as the Code of Conduct Bureau. They must commit to training of personnel and the judiciary must be prudent and up to the task.

Most importantly, we advise that the Policy be implemented guardedly. As laudable and desirable as it is to have an economy dominated by electronic payment, the extent and complexity of the impact of the policy and the dramatic changes the policy would engender requires patient implementation to ensure the objectives are achieved successfully.

²² Francis Pisani; Learning From Kenyan; Mobile Money Transfer and Co-working spaces available at

<http://thenextweb.com/africa/2012/02/05/learning-from-kenya-mobile-money-transfer-and-co-working-spaces/>

²³ Ibid

²⁴ Collins Nweze: Mobile money: The unbanked's bank.

Available at

<http://www.thenationonline.net/2011/index.php/feed/business/money/36815-mobile-money%3A-the-unbanked%E2%80%99s-bank.txt> last assessed on 27/02/2012

²⁵ Ibid.

PRIVATE EQUITY INVESTMENTS IN NIGERIA –AN OVERVIEW

Introduction

As the most important source of funding in the entrepreneurial marketplace, Private Equity (“PE”) refers to equity securities in private companies that are not publicly traded. A Private Equity Fund (“PEF”) as such is a Collective Investment Scheme (“CIS”) employed for making investments in various equity securities in accordance with a single investment model linked to private equity. PE funds are in a category similar to limited partnerships, involving a fixed time period of between seven to ten years, which can be extended on an annual basis. These funds are usually marketed to high net-worth institutions.

As a CIS, PEFs reduce the involvement of the investor and relieve him from keeping continuous watch on the stock market or looking for appropriate markets to invest. Usually conceived as closed-ended investments, investors in PEFs typically commit at the outset and afterwards cannot redeem their interests. The funds draw down the commitments from investors as necessary to make a considerable number of investments, and as investments are realized, the proceeds are received and distributed oftentimes without re-investment, thereby making the fund self-liquidating. The fund manager is usually obligated to issue quarterly or semi-annual reports of investments made to investors and inform on



other activities undertaken in the period under consideration.

In recent times, PE investments in Nigeria have witnessed considerable growth. Notable investments within the country include Actis Capital LLP's \$130Million investment in Diamond Bank Nigeria Plc, its \$10.5Million investment in the Palms Shopping Mall (it has since exited from same); Emerging Capital Partner's investment in Notore Chemical Industries Limited¹, Oando Plc², IHS³; African Capital Alliance's investment in MTN Nigeria Communications Limited⁴, the Associated Bus Company Plc⁵ and Swift Networks⁶; as well as a host of others. Most PE deals in the country are hinged on management buyout and restructuring, unlike in developed economies where they consist mainly of leveraged buyouts.

The central theme from the foregoing has been the remarkably safe environment in which these investments have taken place. This newsletter discusses the available PEF structure within Nigeria and regulations guiding their investments. Further along, an analysis of PEF structures in the United States of America is undertaken towards appreciating the nature of PEFs.

PRIVATE EQUITY FUND STRUCTURES

The major consideration in structuring PEFs is averting the additional stratum of taxation (otherwise known as double taxation). Typically, the fund will be taxed when it realizes an investment or receives income, and likewise the investor upon the realization of investments in the fund or upon receiving income. For this reason most Nigerian-

¹Under ECP Africa Fund II PCC

²Under ECP Africa Fund II PCC

³Under ECP Africa Fund III PCC

⁴Under CAPE I. It exited fully in 2008 through a management sale and private placement.

⁵Under CAPE I. It exited in 2008 through an IPO.

⁶Under CAPE II.

promoted PEFs are often set up in tax haven jurisdictions such as the British Virgin Islands and Mauritius.

PEFs are mostly set up as incorporated entities under the provisions of the Companies and Allied Matters Act (the "Act" or "CAMA")⁷. Where set up as a company limited by shares, such PEF (which is a Special Purpose Vehicle through which investments are made) is required by its Memorandum and Articles to state specifically the type of business that it intends to carry out. Where incorporated as a company under CAMA, such PEFs are liable to tax on company income tax. In Lagos state however, most PEFs are set up as limited partnerships under the Partnership Law of Lagos State⁸. Under this structure, there is at least one general partner (usually the Fund Manager) whose liability for all the debts and obligations of the Fund is unlimited, and other limited partners who are investors in the Fund, but are not liable for the debts and obligations of the Fund beyond their respective contributions. The fund manager manages the fund's business while the fund's investors as limited partners do not participate in the day-to-day management of the business, but may receive certain investment approved rights under the terms of their constituting documents. It must be noted that once the PEF is registered as a limited partnership under the Laws of Lagos State, such partnership can carry on business throughout the federation. Where however, the name of the fund does not include any of the names of its promoters, the provisions of CAMA requires that the name of the fund must be registered as a Business Name under part B of the Act.

SECURITIES & EXCHANGE COMMISSION RULES ON PE INVESTMENTS IN NIGERIA

Prior to the release of the 2011 SEC⁹ Consolidated Rules and Regulations (the "Rules") by the Securities

⁷Cap C20, Laws of the Federation 2004

⁸Section 46

⁹Securities and Exchange Commission

and Exchange Commission (“SEC” or the “Commission”), there were no existing specific regulations on the establishment, management and operation of PEFs in Nigeria. Depending on the transaction and investment type, there are a number of specific rules that must be complied with. The Rules subject PEFs operating in the country to authorization and registration with the Commission¹⁰. Where Fund Managers intend to invest the assets of a fund in unlisted securities, they are required to have a minimum paid-up capital of N500,000,000 (Five Hundred Million Naira), unimpaired by losses or such amount as may be prescribed by the Commission from time¹¹ to time. Further, the Rules require the partners, principals and sponsored individuals to have been in the business of PE investment management for a minimum period of five years¹². Investment in unlisted securities of a company is only permitted where such investee company has demonstrated compliance with the code of corporate governance; has consistently produced audited accounts for the preceding 5 years; and has a consistent history of profitability for at least the preceding 5 years¹³.

The Rules provide also that PEFs shall not solicit funds from the general public but have their funds sourced from qualified investors alone. They are also not allowed to invest more than 30% of the Funds in a single investment¹⁴. It should be borne in mind however that the foregoing provisions apply to all PEFs with a minimum investors' funds commitment of N1Billion¹⁵.

LOCAL INVESTMENTS IN PEFS

PEFs may solicit investments from target local investors such as high net-worth individuals, banks,

insurance companies and pension funds. Investments by banks, insurance companies and pension funds are however strictly regulated by the Banks and other Financial Institutions Act (“BOFIA”)¹⁶, the Insurance Act¹⁷ and the Regulation on Investment of Pension Fund Assets 2010¹⁸ respectively.

Under BOFIA, banks are prevented from acquiring or holding any part of the share capital of any financial, commercial or other undertaking, subject to certain exceptions¹⁹. Subject to the approval of the Central Bank of Nigeria (CBN), banks can invest in any company set up to promote the development of the Nigerian money and capital markets or improve the financial machinery for financing economic development. The CBN prudential guidelines for commercial banks²⁰ however limits the type of investments that commercial banks can undertake to those investments permissible under BOFIA²¹. In line with CBN regulations, banks can acquire shares in small and medium-scale industries, agricultural enterprises and venture capital companies subject to the condition that the aggregate value of the equity participation of the bank in those enterprises does not at any time exceed 20% of the bank's shareholders funds²² and not more than 40% of the paid up capital of the investee company²³.

The Insurance Act regulates the capacity of insurance companies to invest in Nigeria by mandating that funds of insurance companies must be invested and held in Nigeria²⁴ in certain types of investments. It must be noted that the Act and regulations do not

¹⁰Rule 550 (1) (c)

¹¹Rule 535 (2) (a); Rule 552

¹²Rule 535 (2)(b)

¹³Rule 535 (3)

¹⁴Rule 553

¹⁵Rule 551

¹⁶Cap B3, LFN 2004 (BOFIA)

¹⁷Cap I17, LFN 2004

¹⁸Issued in December 2010

¹⁹Section 21, BOFIA

²⁰CBN Scope, Conditions & Minimum Standards for Commercial Banks Regulations No. 1, 2010

²¹Rule 4

²²Section 21(1)(d)

²³Section 21(1)(c)

²⁴Section 26, Insurance Act

specifically prohibit insurance companies from investing in PEFs, even though they are not listed as permitted investments. Nevertheless, insurance companies have significant PE investments. These investments are required to be disclosed in periodic returns filed with the insurance industry regulator, the National Insurance Commission²⁵.

Prior to December 2010, only Legacy Pension Schemes (CPFAs²⁶ & existing schemes) had PE investments. However, the Regulation on Investment of Pension Fund Assets 2010²⁷ expanded the allowed investment instruments available to pension fund assets to include investment in alternative assets such as PEFs registered with SEC, Supranational Bonds issued by eligible MDFOs²⁸, Open/Close-ended/Hybrid Investment Funds registered with SEC and other instruments²⁹.

Before Pension Fund Assets can be invested in PEFs, such PEFs are required to have a well defined and publicized investment objectives and strategy; satisfactory pre-defined liquidity and exit routes³⁰. Further, the Regulation requires that the PEF must have a minimum of 75% investment in companies or projects in Nigeria. Key principals of the Fund Manager (the CEO and CIO) are required to have at least ten years experience in PE investment. Pension funds have a Global Portfolio Limit of 5% of assets under management in the PEF³¹ and such PEFs are required to have MDFOs as limited partners.

FOREIGN PEFS IN NIGERIA

Foreign investments are mainly regulated by the Nigerian Investment Promotion Commission Act ("NIPC Act")³² and the Foreign Exchange

(Monitoring and Miscellaneous Provisions) Act ("Forex Act")³³. Both legislations permit investments by foreign investors in Nigerian securities either through the primary or secondary market, or by private placement³⁴. The respective legislation also provide for the liberalization of foreign direct investment in Nigeria and permit investors who intend to invest in Nigerian enterprises to do so without the need to seek approvals from numerous regulators.

As with any foreign investor, a foreign PEF (FPEF) – i.e., a Fund set up outside the country – investing in Nigeria is guaranteed the unconditional transferability of funds through an authorized dealer, in freely convertible currency, of dividend and interest on profits attributable to the investment; payment of foreign loans, as well as capital repatriation in the event of liquidation or divestment³⁵. Upon importation of funds for investment in Nigeria, an authorized dealer (usually a license bank) through which the funds were imported is required to issue Certificate of Capital Importation (CCI) to the foreign investor (CCI) evincing the amount of capital imported which is meant to be invested in a Nigerian company³⁶. The CCI enables the PEF to repatriate the proceeds of its Nigerian investments without restriction, net of applicable taxes³⁷. The provisions of CITA require an investee company to withhold tax at the rate of 10% as final tax on such proceeds at source (that is, dividend in the case of equity investment and interest in the case of loans), before remitting the same to the PEF.

While a FPEF does not require SEC notification before making investments in private companies, portfolio

²⁵Section 21, Insurance Act

²⁶Closed Pension Fund Administrators

²⁷Issued in December 2010

²⁸Multilateral Development Finance Organizations

²⁹Regulation 4

³⁰Regulation 5(2)(11)

³¹Regulation 7(1)(8)

³²Cap N117 LFN 2004

³³Cap F34, LFN 2004

³⁴Section 26(2) Forex Act; see also section 21 NIPC Act and Rule 404 of SEC Rules

³⁵Section 24, NIPC Act

³⁶Section 15(2) Forex Act. See also Rule 406(1) SEC Rules

³⁷Section 15(4) Forex Act

investments in securities of companies listed on the stock exchange require SEC notification and must be made through SEC-registered capital market operators or licensed brokers and/or dealers³⁸.

ACQUISITION OF SECURITIES

In structuring PE transactions, one of the first tasks of the fund manager is identifying an investee company. The nature of the Fund's investment in the investee company could be equity, debt, convertible debt or even a combination of two or more of these types of investments.

Equity investment makes it easier for the Fund to control and monitor the activities of the investee company since the Fund's equity will entitle it to vote at the general meeting of the company and usually participate on the board. The parties may enter into an Equity Purchase Agreement (EPA) to outline the terms and conditions for acquiring the investee company's shares and upon such acquisition, the Fund must ensure that its name is entered in the investee company's register of members. A common provision in the EPA is the delivery of share certificates by the investee company to the PEF.

Where the investment is a private investment in a public entity (PIPE), then attention must be paid to provisions of CAMA on the delivery of share certificates³⁹. This is because the parties must take into consideration recent steps by the Nigerian Stock Exchange (NSE) to fully dematerialize share certificates of investors holding shares in companies listed on the exchange, through its clearing house, the Central Securities Clearing Systems Limited (CSCS). Shareholders are expected to open CSCS accounts through a stockbroker registered with the Securities and Exchange Commission (SEC) and obtain a CSCS Clearing House Identification Number.

³⁸Rule 408

³⁹Section 146

Apart from just being entitled to vote at the general meeting, the Fund will also seek to protect its stake as a shareholder of the company. It could, by way of a Shareholders' Agreement where the investment is a private one, or a Subscription Agreement where the investment is a PIPE, ensure that there are share transfer restrictions and anti-dilution provisions. For example, rights of first refusal, rights of first offer, tag-along and drag-along rights. It is imperative that the Shareholders' Agreement does not contravene the provisions of the articles of association of the investee company, the CAMA and or any other applicable Nigerian laws or regulations.

In order to ensure maximum returns on its investment, the Fund will naturally be interested in the good governance and management of the investee company. The Fund would thus ensure that the powers of directors to manage the company are exercised in good faith and in the Fund's interests. Accordingly, the Fund would require that the Shareholders' Agreement provides that it has powers to appoint directors, thereby assuring its representation on the board of the investee company, especially on committees such as the finance and audit committees. It should be noted that this could pose a problem of conflict of interest as under CAMA the board of the investee company is expected to act in the best interests of the company and not the Fund.

The Fund may also engage in loan investments. One of the advantages of loan investment by the Fund is a reduction on tax liability arising from the investment. This is because the interest payments that form a return on the Fund's investment will be deducted from the investee company's earnings before tax. Further, the Companies Income Tax Act Cap C21, LFN 2004 (CITA) grants significant tax exemptions (up to 100% depending on the tenor of the loan, including moratorium and grace period) on interest payments on foreign loans.

EXIT MODELS

The most common forms of exits for PEFs in Nigeria are a trade sale, an offer for sale and an initial public offering (IPO). The manner in which the sale would be carried out depends on the type of company and the terms prescribed in the company's articles. Where the articles provide for pre-emptive rights or other constituting documents in favour of other shareholders, the fund may sell its shares to other existing shareholders.

With respect to investments in private companies, the Fund may sell its equity holdings to other existing shareholders. Where the disposal is made at a profit, the profit will not be subject to capital gains tax (CGT), due to the abolishment of CGT on the sale of shares. Upon the sale, the names of the new shareholders will be entered in the company's register of members.

Where the investment of the PEF is a PIPE, SEC Rules provide that a foreign investor shall divest its holdings in securities in public companies through the Nigerian Stock Exchange or on a recognized over-the-counter market⁴⁰ with respect to shares traded on that market. Divestment of holdings in securities in any other public company shall be done through capital market operators⁴¹. The custodian is mandated by the Rules to notify SEC of the particulars of the divestment by the foreign investor within five working days of such divestment.

The Fund could also exit from private investee companies through an IPO. However, IPOs are extensively regulated by the SEC and the conversion of the investee company to a public company will be necessary before the IPO is undertaken. The NSE listing rules require that the company should apply

in the prescribed form for listing of its shares on the NSE. Before making the application, certain requirements must be complied with. At least 25% of the share capital of the company having a nominal value of at least N250,000 shall be made available to the public; the number of shareholders must not be less than 300 unless otherwise approved by the Council of the NSE; and the securities must be fully paid up at the time of allotment.

THE US APPROACH

The Limited Partnership ("LP") organized under the laws of the State of Delaware is the most commonly used fund structure in the United States ("US") with respect to domestic private equity funds. While an LP may be formed under the laws of any of the 50 states that comprise the US, Delaware is usually preferred due to its relatively flexible and highly developed laws on limited partnerships and other business entities.

The limited partnership structure for a fund usually comprises a single general partner and multiple limited partners that are investors in the fund. This structure effectively allows the limited partners to limit their individual liability to their commitments to the fund. Usually, the structure of any particular fund will be tailored to the fund's investor base, geographic focus, industry focus and a number of other factors that touch on various tax issues and regulatory concerns.

In the majority of cases, the general partner exists as a separate legal entity owned by the founders of the fund. After setting up the fund, the founders are usually admitted as limited partners in the arrangement, while a limited liability company that is wholly-owned by the founders will be admitted as a general partner, possessing only a small economic interest in the general partner of the fund. In essence, this system accords the founders with limited liability and at the same time, allows them to receive their share of the general partner's carried interest through the limited partnership.

⁴⁰Rule 410(a)

⁴¹Rule 410(b)

The fund is managed by a management company set up by the founders; and for each fund arranged by the founders, the management company undertakes the responsibility of the day to day operations of the funds. This allows the founders to centralize the management functions of the various funds in one entity. In order to shield the fund managers from liability, the management company is structured as a Delaware corporation or limited liability company.

PEFs that are structured as limited partnerships in the US are regulated by the Securities Act of 1933⁴² which requires amongst others that the sale of securities must be registered with the appropriate regulatory body, unless such offerings qualify for an exemption to the registration requirements⁴³. Regulation S allows a number of non-US securities offerings to be deemed as occurring outside the US, which in essence allows them to avoid registration. This is only possible where the offer is regarded as an offshore transaction, in which case the offer must be made to non-US entities. The exemptions provided for under sections 3(c)(1) and 3(c)(7) of the US Investment Company Act 1940 provides US PEFs with the avenue to avoid the strict regulations of the Investment Company Act, which would normally require such PEFs to register with the Securities and Exchange Commission as investment companies and be subject to burdensome regulations.

The US Employee Retirement Income Security Act of 1974 as amended (ERISA) regulates investments made by ERISA Plans in PEFs as the fund's assets would be deemed to be assets of the investing benefit plan, thereby subjecting the fund to various onerous rules which typically, these funds have difficulty complying with. By imposing this

fiduciary duty on the fund manager, they must then employ their best efforts to cause the fund to qualify for an exemption under ERISA.

The four principal categories of investors in PEFs are non-US investors, US taxable investors, US tax-exempt entities and foreign governments.

CONCLUSION

PEFs are complex transactions, and no less is their structuring. No doubt the Rules has assisted in providing some form of guidance as to operations of PEFs in the country; nevertheless the contents of the Rules are such that they do not adequately address the growth of PE investments in the country. It is important that a country's PEF structure accommodates the needs of both domestic and foreign investors, as shortcomings in this area could lead investors to seek out alternative foreign structures, which in turn will diminish domestic investors' contributions to the funds in the country.

We advocate that limited partnership laws be promulgated in other states of the federation as they appear to be the most efficient PEF structure world over. Indeed, the most efficient tax mechanism for investments in PE is one based on tax transparency, which does away with double taxation. Tax transparency ensures that investors are only subject to tax in their home jurisdictions. Where this is not available, the attendant effect will be more funds being set up under a foreign structure and investing in the country as FPEFs.

In today's economy, Funds are increasingly becoming accessible to foreign investors and often make investments in more than one country. This inexorably multiplies the complexities involved. Whereas PE investments in Africa are currently dominated by South Africa, Egypt, Mauritius, Morocco and Tunisia, Nigeria is expected to experience a boom in PE investments. Although Nigeria's private equity sector is not yet as vibrant as those of advanced economies, there is no doubt that

⁴²Regulation D allows issuers to avoid this registration process by offering securities on a controlled basis to accredited investors.

⁴³This is usually referred to as the safe harbour requirement.

further economic reforms will continue to make the environment attractive to PEFs. It is hoped that, as private equity transactions increase and the benefits become clearer, an even more conducive legal and tax environment will be created for the operations and establishment of PEFs in Nigeria

NIGERIA'S PROPOSED ELECTRONIC COMMERCE LEGISLATION: AN OVERVIEW

With the advent of electronic means of communication and information transfer, many businesses and individuals have become accustomed to the speed and efficiency of electronic technologies and have reorganized their operations to take advantage of the resulting cost benefits derived therefrom. This development has paved way for increasing number of transactions to be accomplished and effected through various electronic media, including electronic data interchange, electronic mail, telex, fax and the like. Despite the benefits, these developments are constantly plagued by existing legal barriers to the validity and enforceability of the records and documents which exist solely in the electronic media.

In 1996, the United Nations Commission on International Trade Law (UNCITRAL) adopted a Model Law on Electronic Commerce (UNCITRAL Model Law) with a set of internationally accepted rules aimed at removing legal obstacles and increasing certainty in electronic commerce. Other instruments also adopted by the UNCITRAL include the 2001 Model Law on Electronic Signatures which is aimed at facilitating the use of electronic signatures, and the 2005 United Nations Convention on the Use of Electronic Communications in International Contracts which is focused on ensuring that contracts concluded and other communications exchanged electronically are as valid and enforceable as their traditional paper-based equivalents.



Several countries have since the adoption of the UNCITRAL Model Law implemented national legislation to remove the barriers to electronic commerce, including the United States via the Uniform Electronic Transactions Act 1999 (UETA); New Zealand via the Electronic Transactions Act 2002; Australia via the Electronic Transactions Act 1999;¹ and Malaysia via the Electronic Commerce Act 2006 (Act 658). These countries have also adopted separate laws to validate the use of electronic signatures in commercial transactions.² Similarly, the European Union (“EU”) has adopted a number of directives on electronic commerce (e-commerce)³ and electronic signatures (e-signatures)⁴ which have been variously implemented by EU Member States including the United Kingdom.⁵

Nigeria, like many of the countries mentioned in the preceding paragraph, now wishes to remove the barriers to electronic commerce through a proposed legislation currently before the Nigerian National Assembly, the Electronic Commerce (Provision of Legal Recognition) Bill 2011 (the “Bill”). Whilst most of the countries mentioned above, including Australia and the United States seem to have modeled their respective national legislation in line with the recommendations of the UNCITRAL Model Law on Electronic Commerce with necessary modifications, the drafters of the proposed Nigerian legislation appear to have made a wholesale adoption of the provisions of the

Electronic Commerce Act 2006 of Malaysia (ECA), which regrettably failed to make necessary modifications to the UNCITRAL Model Law.

This newsletter thus examines the provisions of the proposed Bill alongside the ECA with a view to determining the efficacy of the proposed legislation in removing existing legal barriers to e-commerce. For a comprehensive review of issues, appropriate references will be made to the UNCITRAL Model Law on Electronic Commerce, the UN Convention on the Use of Electronic Communications in International Contracts and where necessary, UETA.

Scope of the Bill

Like the ECA of Malaysia, the Bill upon passage, will apply to commercial transactions conducted through electronic means including those of the Federal and State Governments in Nigeria.⁶ Under the Bill, “commercial transactions” is defined as any single communication or multiple communications of a commercial nature, whether or not contractual, including any matters relating to supply or exchange of goods and services, agency, investments, finance, banking and insurance.⁷

It seems, however, that the proposed legislation would be prohibited from applying to certain matters included in a schedule to the ECA, which unfortunately was not included in the Bill. If the inclusions in the schedule to the ECA of Malaysia are anything to go by given the wholesale adoption of that law by the drafters of the Bill, it would seem that the prohibited transactions referred to in Section 1(2) of the Bill relate to: a) power of attorney; b) the creation of wills and codicils; c) the creation of trust; and d) negotiable instruments.

The scope of the proposed Nigerian legislation seems clear in some respects, especially as it relates to the

¹ Recent amendments to this legislation are contained in the Electronic Transactions Amendment Act 2011 of Australia.

² See for instance the United States Electronic Signatures in Global and National Commerce Act of 2000 and Malaysian Digital Signature Act of 1997 (Act 562).

³ Directive 1999/93/EC on a Community Framework for Electronic Signatures.

⁴ Directive 2000/31/EC on Certain Legal Aspects of Information Society Services, in particular Electronic Commerce, in the Internal Market (Directive on electronic Commerce).

⁵ The United Kingdom implemented these Directives through the Electronic Commerce (EC Directive) Regulations 2002 and Electronic Signatures Regulations 2002 respectively.

⁶ See section 1 of the E-Commerce Bill 2011.

⁷ See section 24 of the E-Commerce Bill. This definition is a replica of that contained in section 5 of the ECA 2006 of Malaysia.

requirement of interaction between two or more persons before a transaction can be described as a covered transaction; a transaction within the ambit of the proposed legislation. So that unilateral acts which do not involve another party, such as execution of will, trust or power of attorney could be removed from the scope of the Act when implemented. Nevertheless, the Bill failed to set forth a clear framework for covered transactions in many other respects.

It will be difficult to ascertain for instance, what matters are covered under the phrase "matters relating to supply or exchange of goods and services, agency, investments, finance, banking and insurance" as used in the definition of "commercial transactions". Parties may rely on that ground to extend the scope of the Act to every conceivable electronic record, document or communication, especially in banking and financial activities, including audit and accounting records. In this regard, it is important to realize that the definition of the term "commercial" in Article 18 of the UNCITRAL Model Law on E-Commerce is merely intended to serve as a guide and should not be strictly followed to give the broadest interpretation to such terms.

Legal Recognition of Electronic Messages

One of the objectives of the law on e-commerce is the need to ensure that records and documents are not considered invalid solely by the reason of the fact that

they exist in electronic form. The UNCITRAL Model Law on E-Commerce proposes in Article 5 that "Information shall not be denied legal effect, validity or enforceability solely on the grounds that it is in the form of a data message." Similarly, Section 6 of the ECA provides that "Information shall not be denied legal effect, validity or enforceability solely on the grounds that it is not contained in the electronic message purporting to give rise to such

legal effect, but is merely referred to in that electronic message."

Even though they are used in the 1996 Model Law, it is difficult in practice to reconcile the use of the term "information" in relation to "validity and enforcement." Little wonder therefore that the 2005 UN Convention on E-Commerce in International Contracts chose instead to state that "a communication or a contract shall not be denied validity or enforcement on the sole ground that it is in the form of an electronic communication."⁸ The term "commercial" should be given a wide interpretation so as to cover matters arising from all relationships of a commercial nature, whether contractual or not. Relationships of a commercial nature include, but are not limited to, the following transactions: any trade transaction for the supply or exchange of goods or services; distribution agreement; commercial representation or agency; factoring; leasing; construction of works; consulting; engineering; licensing; investment; financing; banking; insurance; exploitation agreement or concession; joint venture and other forms of industrial or business cooperation; carriage of goods or passengers by air, sea, rail or road.

The drafters of the UETA in the United States must have also recognized the ambiguity inherent in the provisions of the Model Law when they stipulated that "[a] record or signature may not be denied legal effect or enforceability solely because it is in electronic form."⁹ The Electronic Transactions Act 1999 of Australia also provides that "... a transaction is not invalid because it took place wholly or partly by means of one or more electronic communications."¹⁰

Notwithstanding the obvious error, both Malaysia via the ECA 2006 and Nigeria via the proposed legislation adopted the provisions of Article 5 of the

⁹ See section 7(a) of UETA. See also section 7(b) of UETA.

¹⁰ Section 8.

1996 Model Law without modifications. It is thus submitted that the adoption of the phrase “[i]nformation shall not be denied ... validity or enforceability solely on the grounds that it is in the form of a data message” in the E-Commerce Bill 2011 is inappropriate, hence should be modified.

Formation and Validity of Electronic Contract

The provisions relating to formation and validity of contracts under the Bill are contained in Section 5. Though short and concise, the Section contains salient provisions worthy of consideration.

a) Formation and Validity of Contracts

Section 5 of the Bill permits formation of contracts through electronic messages. It stipulates in subsection (2) that “a contract shall not be denied legal effect, validity or enforceability on the ground that an electronic message is used in its formation.” Though this Section appears to have been couched in terms similar to Section 7 of the ECA 2006 of Malaysia, the drafters appear to have given some consideration to the recommendations contained in Article 8 of the 1996 Model Law¹¹. Thus, even though the two provisions were couched differently, the intent appears to be identical, that is a contract shall not be invalidated by the mere fact that it was formed through an electronic medium.¹² Such contracts may nevertheless be invalidated on other grounds.

In relation to formation, Section 5(1) of the Bill starts out with the phrase “in the formation of a contract,” thus, giving an indication that a contract or agreement existing in an electronic form is protected only at the time of formation. That section simply states that:

¹¹ Where any law requires information to be in writing, the requirement of the law is fulfilled if the information is contained in an electronic message that is accessible and intelligible so as to be usable for subsequent reference

“[i]n the formation of a contract, the communication of proposals, acceptance of proposals, and revocation of proposals and acceptances or any related communication may be expressed by an electronic message.”

The above provision poses questions such as; what happens after the contract has been formed? Would the parties' electronic exchanges at the time of performance, such as any notices of defective performance,

offers to pay or recognition of debt, still be enforceable under the Bill? Is there any possibility that the phrase “or any related communication” could be interpreted to mean communication made during performance. This does not seem likely as the intention of the drafters to restrict the provision to the contract formation stage is clearly evident in the provision. However, even if such a possibility could be inferred, one question that still remains is why the need for the ambiguity and uncertainty? It is submitted that given the place of electronic communications in development, the legislature ought to use the opportunity of this piece of legislation to resolve uncertainties and not add to it.

Similarly, the use of the term “proposal” in Section 5(1) of the Bill adds to the uncertainty surrounding certain portions of the proposed legislation. Admitted, “proposal” could be interpreted to mean the same thing as “offer,” but why subject a proposed legislation as important to commercial development as this piece of legislation to such a rigorous interpretation when the term “offer,” which has been given definite interpretations by courts in Nigeria, can be used?¹³ It is important to point out that in this instance the Bill failed to adopt the guide proposed

¹² See also Article 8 of the 2005 UN Convention on Use of Electronic Communications in International Contracts.

¹³ See the recent Nigerian Supreme Court decision per J.A. Fabiyi, JSC in *Bilante International Ltd v. Nigerian Deposit Insurance Corporation* (2011) LPELR-SC 177/1996

by the 1996 Model Law.¹⁴ Rather, Section 5(1) of the Bill contains exactly the same provisions as Section 7(1) of the ECA 2006 of Malaysia. This suggests that the drafters of the Bill adopted substantially, the provisions of the ECA 2006 of Malaysia without modification and due regard to the implications of such adoption in a country where such terms were previously non-existent. A simple research into the history of the Malaysian contract law would have revealed that the term "proposal" was used in relation to "offer" as far back as 1950 under the Contracts Act 1950 (Act 136) of Malaysia and has since been the subject of several court interpretations. Incorporation of such a term into a Nigerian legislation with no history of previous use may therefore cause more harm than good. Thus, the Section of the Bill should be redrafted to align the terms with the practice currently applicable in Nigeria.

b) Requirements as to Form

This is another important area with the potential to be most beneficial to members of the business community, as well as individuals engaged in commercial transactions. The 1996 UNCITRAL Model Law recommends adoption of provisions that would confer validity on electronic records when in practice national laws require such records to be in writing, signed by the parties and in the original form.

i) Writing

Article 6 of the 1996 Model Law recommends that:

"[w]here the law requires information to be in writing, that requirement is met by a data

¹⁴ Article 11 provides that in the context of contract formation, unless otherwise agreed by the parties, an offer and the acceptance of an offer may be expressed by means of data messages. Where a data message is used in the formation of a contract, that contract shall not be denied validity or enforceability on the sole ground that a data message was used for that purpose.

message if the information contained therein is accessible so as to be usable for subsequent reference."

Rather than adopt this recommendation, the drafters of the E-Commerce Bill chose to adopt a provision similar to Section 8 of the ECA 2006 of Malaysia which provides that:

"[w]here the law requires information to be in writing, the requirement of the law is fulfilled if the information is contained in an electronic message that is accessible and intelligible so as to be usable for subsequent reference."¹⁵

A careful read of Article 6 of the 1996 Model Law and the subsequent 2005 UN Convention¹⁶ will reveal the intent behind the provision, which is to ensure that electronic communications are accessible and not necessarily comprehensible. Thus, the inclusion of the word "intelligible" in Section 6 of the Bill is unnecessary.

ii) Signature

The guide to drafting a national legislation in this regard is contained in Article 7 of the 1996 UNCITRAL Model Law.¹⁷ Yet again, the Bill contains provisions similar to ECA 2006 of Malaysia. However, while Malaysia and most other countries, including the US and UK have implemented separate and comprehensive digital signature statutes, Nigeria has none.¹⁸ It is submitted that rather than adopt a piecemeal approach to electronic communications, the legislature should work on implementing a digital signature statute in the nearest future.

iii) Seal

Section 8(1) of the Bill sought to make a provision to substitute the requirement for seal in electronic documents. It specifies that:

¹⁵ See section 6 of the E-Commerce Bill 2011 which contains exactly the same provision as the Malaysian Law.

¹⁶ Article 9(2).

“[w]here any law requires a seal to affixed to a document, the requirement of the law is fulfilled, if the document is in the form of an electronic message.”

It is submitted that not only is that section incomplete, it also makes no logical sense whatsoever. This submission is given more credence where Section 8(1) of the proposed legislation is read alongside section 8(2) which provides that:

“[n]otwithstanding subsection (1), the Minister may, by order in the Gazette, prescribe any other electronic signature that fulfills the requirement of affixing a seal in an electronic message.”

It is possible that in the bid to avoid reference to digital signature as provided under a digital statute (which is nonexistent under the Nigerian law), the drafters of the Bill deleted more than necessary from Section 10(1) of the ECA 2006 of Malaysia which states that:

“[w]here any law requires a seal to affixed to a document, the requirement of the law is fulfilled, if the document is in the form of an electronic message, by a digital signature as provided under the Digital Signature Act 1997.”

Section 8(2) of the Bill adopted the provisions of section 10(2) of the Malaysian law.

iv) **Retention of Records; Originals**

Provisions relating to these are contained in Articles 8 and 10 of the 1996 UNCITRAL Model Law.¹⁷ Here, as in the entire Bill, the drafters adopted provisions

of the ECA 2006 of Malaysia.²⁰ Section 10 of the Bill provides that:

“[w]here any law requires any document to be in its original form, the requirement of the law is fulfilled by a document in the form an electronic message if –

a) There exists a reliable assurance as to the integrity of the information contained in the electronic message from the time it is first generated in its final form; and b) The electronic message is accessible and intelligible so as to be usable for subsequent reference.” This provision has the potential to become extremely useful to people engaged in commercial transactions in Nigeria. This is because when an electronic message is sent, what the recipient receives is a copy of the message. The copy may subsequently be stored, read or sent, but in most situations, only the copy of the original message is used. The implementation of the proposed E-Commerce legislation would complement the recent inclusions in Section 84 of the Nigerian Evidence Act of 2011,²¹ for such records to be used in court so long as the requirements in (a) and (b) above, as well as Section 10(2) are met. Nevertheless, nothing in the Bill relieves a party from the duty to adduce the necessary foundation for admission of the electronic record.

It is pertinent to note that as previously submitted the word “intelligible” as used in (b) above, as well as under the provision relating to retention of documents in Section 10 of the Bill may need to be deleted.

c) **Admissibility and Weight of Evidence**

¹⁷ See also Article 9(3) of the 2005 UN Convention.

¹⁸ Please note the recent inclusions in section 93(2) of the Nigerian Evidence Act 2011.

¹⁹ See also Article 9(4) and (5) of the 2005 UN Convention.

²⁰ See sections 12 and 13 of the ECA 2006 of Malaysia.

²¹ The section contains provisions on admissibility of statements in documents produced by computers.

²² See section 20 of the ECA.

Even though Article 9 of the 1996 UNCITRAL Model Law made effective recommendations for inclusion of provisions on admissibility of data messages in national legislation, the Bill, like the ECA 2006 of Malaysia failed to adopt the recommendation. Article 9(1) of Model Law suggests inclusions as follows:

"[i]n any legal proceedings, nothing in the application of the rules of evidence shall apply so as to deny the admissibility of data message in evidence:

- a) On the sole ground that it is a data message; or
- b) If it is in the best evidence that the person adducing it could reasonably be expected to obtain, on the grounds that it is not in its original form."

The Model Law continued in Article 9(2) to make recommendations on the weight of evidence to be attached to data existing solely in electronic form as follows: "[i]nformation in the form of a data message shall be given due evidential weight. In assessing the evidential weight of a data message, regard shall be had to the reliability of the manner in which the data message was generated, stored or communicated, to the reliability of the manner in which the integrity of the information was maintained, to the manner in which its originator was identified, and to any other relevant factor."

Quite surprisingly, these provisions were omitted from the Bill. It is imperative that the legislature ensures that relevant provisions of the 1996 UNCITRAL Model Law are reflected in proposed legislation.

d) Time of Dispatch and Receipt

With respect to the time of dispatch of electronic communications, Section 18 of the Bill provides as follows:

"Unless otherwise agreed between the originator and the addressee, an electronic message is

deemed sent when it enters an information processing system outside the control of the originator."

Again, this is a direct adoption of the provisions of the ECA 2006 of Malaysia.²² However, in adopting the Malaysian provision, S.18 of the Bill failed to include provisions contained in the second part of Article 15(1) of the UNCITRAL Model Law which envisages that an electronic message may in some cases be sent by a person other than the originator. Article 15(1) states as follows:

"Unless otherwise agreed between the originator and the addressee, an electronic message is deemed sent when it enters an information processing system outside the control of the originator or of the person who sent the data message on behalf of the originator."

It is pertinent to note that the provision included in the UNCITRAL Model Law would more appropriately take care of situations where the originator, such as a director of a company, directs another such as a secretary to send communications on his behalf. Where the clarification is not made, as in S.18 of the Bill, an electronic message emanating from the secretary on behalf of the originator for instance, would not be covered under the Bill, since the secretary cannot acquire the status of the originator of the electronic message.

Similarly, with respect to the time of receipt of electronic messages, S. 19 of the Bill merely covers situations where the addressee has designated an information processing system for the purpose of retrieving electronic messages and where he (the addressee) has not designated a system. In the former situation, an electronic message is deemed received when it enters into the designated information processing system, whereas in the latter situation, it is deemed received when it comes to the knowledge of the addressee.

That provision fails to reflect the provision of Article 15(2) of the UNCITRAL Model Law which is more comprehensive. Article 15(2) covers three important scenarios as follows: a) if the addressee has a designated information system for receiving data messages, receipt occurs – i) when the data message enters the designated system; or ii) if sent to a system that is not the designated information system, when the data message is retrieved by the addressee; b) if the addressee has not designated an information system, receipt occurs when the data message enters an information system of the addressee. Not only is Article 15(2) more comprehensive, it also ensures that a party does not have to wait indefinitely for an electronic message to come to the knowledge of the addressee with no designated information system. Thus, under the Model Law, time of receipt would begin to count when the data message enters any information system of the addressee whether or not he is aware of same.

The Legislature may also need to take note of Article 10(2) of the 2005 UN Convention which provides that the time of receipt of an electronic communication would be the time when it becomes capable of being retrieved by the addressee at an electronic address designated by him. Where the addressee did not designate the address, the time of receipt is the time when the communication becomes capable of being retrieved and the addressee is aware that the communication was sent to that address.

Conclusion

This newsletter gives a brief overview of some of the salient provisions of the Bill worthy of further consideration before enactment. Given the importance of this piece of legislation to economic development in Nigeria, efforts should be made towards ensuring that each provision is carefully analyzed and possibly modified for applicability to the Nigerian context.

In conclusion, care should be taken when analyzing the statute to ensure that all forms of ambiguities and uncertainties are removed.

A large, light gray, stylized letter 'D' graphic that serves as a background for the central text. The 'D' is composed of a thick vertical bar on the left and a curved top and bottom section on the right. In the center of the 'D' is a white circle containing the text 'OIL & GAS'.

OIL & GAS



GAS FLARING IN NIGERIA: AN OVERVIEW OF THE ASSOCIATED GAS RE-INJECTION (AMENDMENT) BILL 2010 (THE “BILL”)

Introduction

There are estimations that about 40% of Nigeria's gas is flared as it is produced; thus accounting for 12.5% of the world's flared gas second only to Russia.¹ Between 1970 and 2006, Nigeria lost about USD \$72 Billion (an average of USD\$2.5 Billion per annum) to Gas Flaring.²

Gas Flaring Has BeEn defined as the complex and unscientific burning and emitting of excess hydrocarbons Consisting of substantial amount of soot, carbon monoxide and green house gases associated with crude oil and gas production processes.³ It is the Final phase Of The production process where Unwanted and unutilized quantities of oil and gas are flared directly into the atmosphere.⁴ The unutilized gas from this practice could be

¹World Bank, Partners Kick off New Phase, Renew Commitment to Gas Flaring Reduction available at <http://web.worldbank.org>.

²Gas Flaring: Nigeria lost \$72billion by the Nigerian Gas Association at www.enownow.com/news/story.php?sno=412

³Nwokezi John Ikoro : “*The Soco Economic Implications of Gas Flaring in Nigeria*” available at <http://ogbakingdom.com/the-socio-economic-implications-of-gas-flaring-in-nigeria-by-nwokezi-john-ikoro/>

⁴Ibid



applied towards other productive purposes such as power generation and liquefied natural gas projects like the Nigeria Liquefied Natural Gas Project (NLNG). Other uses include gas re-injection processes to boost oil production, domestic cooking gas, gas to liquid projects, other production processes such as the manufacture of fertilizers and plastic products.

Over the years, the Federal Government of Nigeria has been in talks with the International Oil Companies ("IOCs")⁵ on ending this practice and exploiting same for industrialization purposes.

This Newsletter presents an overview of the gas flaring regulatory regime in Nigeria with the focal point on the provisions of the Associated Gas Re-injection (Amendment) Bill, 2010 (the "Bill"). In addition the Newsletter highlights the recent efforts made thus far towards achieving the 2012 deadline to finally end gas flaring and examines the Norwegian policies on Gas Flaring.

Highlights of the Gas Flaring Regime in Nigeria till date

The Gas Flaring Regime in Nigeria spans back to 1979. Pursuant to Section 3 of the Associated Reinjection Act of 1979 (the "Act")⁶, the Government of Nigeria made it illegal for any person or organization to engage in gas flaring practices. This illegality may be waived by a certificate of issuance from the Minister of Petroleum within the powers granted under the Act. The number of gas flaring sites in Nigeria has increased considerably as a result of this waiver of illegality.⁷

The Act has been amended several times with the

⁵The IOCs engaged in oil and gas exploration.

⁶Cap.A25 laws of the Federation of Nigeria, 2004 (the "Act")

⁷Tunde Obadina: "*Nigeria: Harnessing Abundant Gas Reserves*" available at <http://www.un.org/ecosocdev/geninfo/afrec/subjindx/131ni gr7.htm>

common feature in the various amendments being the date to put an end to gas flaring in Nigeria. The Act prohibited gas flaring in Nigeria and set January 1, 1984 as the deadline to put an end to gas flaring. However the January 1, 1984 date has been reviewed a couple of times by subsequent amendments.

The January 1, 1984 deadline was amended by the Associated Gas Re-Injection (Continued Flaring of Gas Regulations) 1984 and the Associated Gas Re-Injection (Amendment) Decree No. 7 of 1985 (the "Decree"). The Decree reviewed the Act and introduced the granting of permits by the Minister for continuation of gas flaring by all Exploration & Production (E&P) companies with a proviso for the payment of paltry fines as penalty which to all effect was simply nominal. Further amendments were introduced up until the Associated Gas Re-Injection (Amendment) Bill, 2008 which fixed the abortive deadline on December 31, 2008. Subsequently the Gas Flaring (Prohibition and Punishment) Bill 2009 further pegged December 31, 2010 as the deadline for an end to the practice.

However, in January 2010, the Nigerian House of Representatives considered the report of its committees on Gas Resources and Justice on a Bill for an Act to amend the Associated Gas Re-injection Act, and accepted a new deadline pitched for December 31, 2012.

Highlights of the Bill

The Bill amongst other provisions sets December 2012 as the new deadline for gas flaring in Nigeria. It also provides for the grant of temporary gas flaring permits to operators⁸ and also imposes penalties for gas flaring. The major highlights of the Bill are discussed below.

December 2012 Deadline

⁸Companies involved in oil and gas production activities.

The Bill prohibits companies engaged in the production of oil and gas from flaring gas after December 31, 2012 beyond the permitted minimum.⁹ By this provision, oil producing companies in Nigeria have been granted yet another extension on the period within which to end the flaring of the excess hydro-carbons gathered in the course of an oil and gas production flow.

Temporary Gas Flaring Permit

Section 3(2) (b) of the Bill permits the Minister to grant a temporary gas flaring permit to any company which seeks to continue to flare gas in particular field or fields on payment of the sum of \$5.00 per 1,000 standard cubic feet of gas flared with a processing fee of \$1,000. However, a temporary gas penalty is payable for any gas flared in excess of approved gas volumes during pre-commissioning and commissioning operations, equipment maintenance and operation upset.

This amendment is a welcome development and perhaps may be described as a step in the right direction when compared to the 1979 Act which allowed the Minister to permit gas flaring for a period of 30 days in the cases of start-up, equipment failure or shut down without having to pay for such gas flared. Furthermore, this is a departure from the Associated Gas Re-Injection (Amendment) Decree of 1985 which fixed a paltry fine of 2 Kobo (equivalent to US\$0.0009 in 1985) against the oil companies for each 1000 standard cubic feet (scf) of gas flared.

Gas Utilization Plan

While the 1979 Act required all Operators to prepare programs for gas utilization or reinjection and strictly limited the grounds upon which flaring could be permitted, the Bill provides that no

⁹S.3(1) of the Bill provides that *"No company engaged in the production of oil and gas shall after December 31, 2012 flare gas produced in association with oil, other than such minimum allowed by the Minister by regulation"*.

company without facilities for associated gas utilization shall be permitted to engage in oil production.

Thus the Bill seems to reaffirm the commitment of the Federal Government of Nigeria to ensure that the hitherto flared gas is put to productive use. This is a giant step towards ensuring the utilization of gas by IOCs which had previously cited the high cost of implementing gas utilization facilities as the reason for not complying with the set deadlines. Thus, enforcing the availability of gas utilization facilities by IOCs despite its huge cost, would further assure the government of its utilization.

Penalty for Gas Flaring

Similar to the provisions of the 1979 Act, the Bill prohibits all companies from engaging in gas flaring whether routine or continuous. Any company so involved shall be liable to a fine to be determined at the prevailing international gas market price and the applicable fine shall not be regarded as part of Production Sharing Contracts ("PSCs") or Joint Ventures ("JVs") obligations.¹⁰

The penalty provision of the Bill does nothing to resolve the ambiguity raised by previous legislations. The question of how to quantify the cost of gas in the international market still remains. However the provision to the effect that such fine shall not be counted as a part of the PSCs or JVs obligation is a landmark achievement for Nigeria. This results from the fact that the Nigerian government is extricated from liability for fines for gas flaring with respect to PSCs as well as JV Agreements entered into with the IOCs.

One of the reasons why the penalty for gas flaring has been relatively low over the years is because such fines were not separate from the PSC and JV obligations, thus exposing Government to share in the liabilities accruing from the fines imposed on flouting companies. This issue of joint liability has also influenced the adjustments in deadlines.

However, with this provision, it is expected that the IOCs will have no choice than to comply with the 2012 deadline.

Reporting Gas Flaring

Companies are required to report all emergency gas flaring within 24 hours of occurrence, failure of which will attract a fine of US\$500,000.¹¹ The Bill further provides that any company that declares an incorrect volume of flared gas shall be liable to a fine of US\$100,000 and must pay the difference of such wrongly declared volumes at the prevailing international gas market rate. This provision shall to a reasonable extent ensure honesty in the dealings of the companies with the regulatory agencies.

The December 2012 Deadline and Compliance Strategies by IOCs

The new 2012 deadline seems tenable in the light of the new provisions of the Bill. The IOCs are currently pursuing projects to end gas flaring in Nigeria.

In April 2011, Shell Petroleum Development Company of Nigeria Limited and Saipem Contracting Nigeria Limited signed an Agreement to construct a gas pipeline system worth US\$101 Million for the gathering of otherwise flared associated gas. On completion, the project is expected to extend Associated Gas Gathering (AGG) coverage to more than 90% of the associated gas produced in the Joint Venture operations, while the remaining 10% is expected to be covered by Nigerian¹² investors that would collect associated gas from flare sites for small-scale local projects.¹³

Also, Total Exploration and Production Nigeria

Limited, a subsidiary of Total Group signed a Memorandum of Understanding (MOU) with stakeholder communities for the right of way of the strategic Obite, Ubeta and Rumuji (OUR) gas pipeline. It is expected that the MOU would comply with the Federal Government's gas flare out regulations, thereby helping to meet the growing demand for gas in Nigeria as well as supply gas feedstock to the NLNG. Other collaborations include that between Nigerian Agip Oil Company (NAOC) and Oando Nigeria Plc for the construction of a \$3 Billion Central Gas Processing Facility (CGPF) in Nigeria.

Gas Flaring: The Norwegian Experience

Gas Flaring in Norway has decreased considerably over the years. The country is highly regarded as a prime example for the proper management of gas resources. In 2001, Norway initiated a project led by the World Bank which introduced voluntary global standards for restricting gas flaring. The Norwegian Energy Policy has been able to merge its role as a large energy producer alongside developing pioneering position on environmental issues.¹⁴ The Norwegian Petroleum Directorate is working closely with the World Bank and has contributed its experience with the Norwegian system to different projects, by assisting several developing countries in their work to limit gas flaring.

It is against this background that we undertake a brief overview of the Norwegian gas flaring regime.

Gas Utilization Plans

Oil companies in Norway are required to lift, process and use associated gas in their operations. Accordingly, they are to submit a development plan with a provision for gas re-injection, gas export solution or other associated gas utilization schemes.

¹¹Ibid

¹²Bangudu, Oluwaseyi: The Struggle to End Gas Flaring. Reported on Next Community at http://234next.com/csp/cms/sites/Next/Money/5689121147/the_struggle_to_end_gas_flaring.csp

¹³Shell, Saipem seal \$101 Million pact on gas flare reduction available at www.valuefronteira.com

¹⁴Regulation of Associated Gas Flaring and Venting. A Global Overview and Lessons from International Experience", the World Bank Report, No 3 available at <http://rru.worldbank.org/documents/publicpolicyjournal/279gerner.pdf>

In 2004, only 0.16% of the total annual associated gas from oil production was flared in Norway.¹⁵ Similar provisions have been adopted in Nigeria by the 2010 amendment which requires the availability of gas utilization facilities. It is hoped that in the nearest future the amount of gas flared would be of a negligible quantity.

Regulatory Agencies

In Norway a regulatory body called the Norwegian Petroleum Directorate (NPD) which is a part of the Ministry of Petroleum and Energy (MPE) supervises air emissions as well as petroleum activities and is responsible for energy efficiency and safety of installations and gas flaring and venting operations in Norway.

Gas Flaring Permits

The *Petroleum Activities Act*, No 72, 1996 of Norway provides for a very strict permission procedure. Section 4.4 of the Act provides that "Flaring of petroleum in excess of the quantities needed for normal operational safety shall not be allowed unless approved by the Ministry. Upon application from the licensee, the Ministry shall stipulate, for fixed periods of time, the quantity which may be produced, injected or vented at all times".

Applications for obtaining gas flaring permits are evaluated directly by the NDP and permits are issued by the MPE. As a part of the approval procedure, the NPD and MPE evaluate the flaring equipment and operating procedures. The application for obtaining permit must identify the type and level of the atmospheric emissions and technology applied to avoid or reduce environmental pollution. Emission limits are established on a case-by-case basis taking into

¹⁵Gas Flaring: The Norwegian Experience, Official Report introduced by Norwegian Petroleum Directorate, , presented in Johannesburg Summit in August 2002 available at http://www.dundee.ac.uk/cepmlp/car/html/CAR10_ARTICLE14.PDF

consideration applicable national and regional standards.

These procedures are commendable and ensure a system of checks and balances in the industry and may be worthy of emulation in the Nigerian oil and gas industry.

Measuring and Reporting

Norway has effective measuring and reporting procedures which are carried out by both the government and the oil producing companies.

The Government through the NPD:

- supervises the internal control systems of oil companies to ensure that petroleum activities are carried out in accordance with the requirements of the law.
- audits the application of the equipment that measures the quantity of gas used for flaring and venting.
- obtains and evaluates reports, submitted by the oil companies.

The oil companies on the other hand:

- are to establish internal control systems for ensuring compliance, such as obligation to check sensor calibration every six months.
- are required to keep an emissions inventory which is to be submitted to NPD before March 1 of each year.
- have to submit a Report to the State authorities, indicating the amount of gas flared daily.
- have to report volumes of the flared

gas for tax purposes every six months.¹⁶

In Nigeria, while the oil companies are to report every case of emergency gas flaring as a result of equipment failure, there appears to be no obligations on regulatory bodies towards enforcing their regulatory roles.

Editorial

The Bill commendably addressed the major issues which had hitherto been relied upon as a justification by oil and gas companies for their failure to adhere to previous laid down deadlines to end gas flaring. However, a key factor to Nigeria's goal of ending gas flaring is the enforcement of legislations on this subject.

The Norwegian experience and its methods of gas resource management is a role model for countries undergoing gas flaring reforms. It is therefore hoped that Nigeria would extract lessons from the Norwegian gas flare regime particularly with respect to measuring and reporting mechanisms as well as ensuring that the regulatory agencies ensure the enforcement of all applicable legislation.

If properly implemented, there is no doubt that the 2010 amendment is a commendable effort in view of the economic and environmental impact of gas flaring on the Nation. While there remains several mechanisms towards ensuring a near total elimination of gas flaring in Nigeria particularly by taking lessons from the gas flaring regimes of other jurisdictions, it is anticipated that the 2012 deadline would result in a significant reduction in the amount of gas flared by IOCs in Nigeria.

¹⁶Ibid

MARGINAL FIELDS IN NIGERIA: AN OVERVIEW OF THE ENABLING PROVISION AND FISCAL REGIME

Introduction

It is estimated that the Petroleum Industry accounts for 90% of the total government revenue (approximately 20% of the Gross Domestic Product) in Nigeria.¹ This explains the Federal Government of Nigeria's policy objective to expand its reserves to 40 billion barrels by 2011 using the most resourceful and financially viable method.² One major approach towards achieving this set objective is the development of Marginal Fields Development Programme (MFDP).

The MFDP amongst other objectives seeks to discourage continuous holding of undeveloped fields by International Oil Companies (IOCs), reduce the rates of abandonment of depleting fields and assure the Government's take in acreages which would otherwise have become unproductive. Furthermore, the MFDP is recognized as a means of encouraging Indigenous Oil and Gas Companies (IOGCs) to develop the required technical and managerial competence required to handle challenges in the Sector.

¹United States Energy Information Administration, *Nigeria*, available at <http://www.afbis.com/Nigeria/vision.ht>

²Oroma O.J: *What are the Legal and Contractual Implications of the 40% Cap on Foreign Equity Participation in Nigerian Marginal Fields?* Available at www.dundee.ac.uk/cepmlp/gateway/files.php



Marginal Fields has been defined as “oil production fields which form part of a country’s oil reserves that have been left undeveloped or unattended due to a consideration of facts ranging from the economic non-viability of such fields to the high costs of developing these fields.”³ Its importance to the Nigerian economy cannot be over emphasized and the fact that Marginal Fields help empower IOGCs which in effect is a means of controlling capital flight from the operations of IOCs cannot be neglected.

This newsletter presents an overview of the regulatory regime of Marginal Fields in Nigeria focusing on the provisions of Petroleum Amendment Act 1996. In addition, the newsletter compares the Nigerian fiscal regime on Marginal Fields with the regulation of the United Kingdom (UK) Continental Shelf.

Marginal Fields in Nigeria

The Petroleum (Amendment) Act of 1996 (the “Act”) was the first legislation to address the absence of a policy on the acquisition of Marginal Fields in Nigeria by interested investors. Paragraph 16A of the Act provides for the farm-out of marginal fields.

In July 2001, the Office of the Presidential Adviser on Petroleum and Energy released a “*Guideline on farm-out and operation of Marginal Fields*” (the “Guideline”), which constitutes the protocol for the government regulator, *farmors* and *farmees* in marginal fields operations.

Highlights of the Act and Guideline

The Act and the Guideline amongst other provisions, provides for the voluntary and compulsory farm-out of Marginal Fields subject to the consent of the President. The major highlights are further discussed below.

³Okagbue, N.S., Olabampe, A: “*Legal Framework for the Acquisition of Marginal Fields in Nigeria.*” available at heinonlinebackup.com/hol-cgi-bin/get_pdf.cgi?handle=hein.journals/

Definition of Marginal Field

The Act defines Marginal Fields as “such Fields as the President may, from time to time, identify as Marginal Fields.”⁴ This definition, apart from being ambiguous, gives the President wide discretion over what Fields qualify as Marginal Fields.

Furthermore the Guideline defines Marginal Fields as “any Field that has reserves reported annually to the Department of Petroleum Resources (DPR) and has remained un-produced for a period of over 10 years.” In addition, it stipulates the characteristics required for a Field to be marginal as follows:

1. Fields not considered by license holders for development because of assumed marginal economics under prevailing fiscal terms;
2. Fields which have had at least one exploratory well drilled on the structure and have been reported as oil and gas discoveries for more than 10 years;
3. Fields with crude oil characteristics different from current streams which cannot be produced through conventional methods or current technology;
4. Fields with high gas and low oil reserves;
5. Fields that have been abandoned by the leaseholders for upwards of 3 years for economic reasons; and
6. Fields which the present leaseholders may consider farming out due to portfolio rationalization.

Operation of Marginal Fields

The Guideline provides that only IOGCs are allowed to apply for or operate Marginal Fields. However, these IOGCs are permitted to have foreign technical partners with equity participation not exceeding 40%.

⁴Paragraph 16A

This attempt by the Government to promote participation of IOGCs in the oil industry is commendable. However, the upstream sector is extremely capital intensive, and requires sound technological expertise which most IOGCs lack. More importantly, the terrain of Marginal Fields is very risky and uncertain and it is undisputable that special drilling technology, equipment, and expertise are essential to make its development lucrative.

In 2003 for instance, the Nigerian Government handed over the operations of 24 Marginal Fields to 31 Nigerian IOGCs⁵ and not many of these companies have made appreciable progress with their concessions.⁶

In as much as foreign partnership is permitted, the magnitude of resources required to be committed by the foreign technical partners to the working of the programme, will dissuade many of them from accepting only 40% equity share, and consequently refrain from participating in the programme. Thus the Marginal Fields so allocated to the indigenous firms may remain undeveloped.

Voluntary and compulsory Farm out of Marginal Fields

Under the Act, the holder of an Oil Mining Licence (OML) may, with the consent of and on such terms and conditions as may be approved by the President, farm-out any Marginal Field which lies within the leased area.⁷ The President may also cause the farm-out of a Marginal Field if such Field has been left unattended for a period of not less than 10 years from the date it was first discovered. The Act defines farm-out as "an agreement between the holder of an OML and a third party which permits the third party

to explore, prospect, win, work and carry away any petroleum encountered in a specified area during the validity of the lease".

This definition is with a proviso to the effect that the President shall not give his consent to a farm out or cause the farm out of a Marginal Field unless he is satisfied

- (a) that it is in the public interest to do so, and in the case of a non producing Field, that the Marginal Field has been left unattended for an unreasonable time (usually more than 10 years); and
- (b) that the parties to the farm-out are in all respects acceptable to the Federal Government of Nigeria.

The Act failed to define what constitutes "public interest," thus causing one to wonder when exactly it will be in the interest of the public for the President to withhold consent with respect to the farm out of a Marginal Field. Again the discretion granted to the President is very wide as he can withhold consent unreasonably and justify it on the grounds of public interest.

Furthermore, the proviso that the President can withhold consent in the case of an unproducing Field where such Field has been left unattended for an unreasonable time not less than 10 years does nothing for the Nigerian Economy. The definition of unreasonable time is ambiguous; it is clear that unreasonable time cannot be less than 10yrs but it can well be more than 10yrs all at the discretion of the President.

In addition, the Act failed to specify the criteria for determining (b) above, i.e. the parties that would be acceptable to the Federal Government of Nigeria.

Nature of title under Marginal Fields

The nature of title with regards to Marginal Fields is somewhat similar to the traditional notions of a Lease and Sub-lease. Firstly, on one hand is a lease between the Government as the lessor and the OML holder as

⁵Feso B: *Nigerian Marginal Fields: Navigating through Financial Storms* available at <http://www.themixoilandwater.com/2011/05/nigerian-marginal-fields-navigating.html>

⁶Ibid

⁷Paragraph 16A (1) of the Act

the lessee and on the other hand is a sub-lease between the OML holder (the “farmor”) as sub-lessor and a Marginal Field holder (the “farmee”) as sub-lessee.

Secondly, paragraph 21 of the Guideline provides that “the Field(s) shall revert to the Marginal Field pool of the Farmor, 24 calendar months after the end of production operation on the Field.” This is similar to what obtains in Leases, where the right of possession at the end of the term of years reverts to the Lessor after the term of years for which the lease was granted.

However, the reversionary interest principle obtainable under a Lease is not applicable to Marginal Fields. This is due to paragraph 19.0 of the Guideline which provides that “if at the end of 24 months of consent to the farm-out agreement, a Farmee shows verifiable evidence of efforts made to progress the work on the Fields according to approved plan and the DPR is satisfied, the farm-out shall be renewed for the remainder life span of the Field.”

The above provision implies the possibility of renewing a farm-out ad-indefinitum which is against the inherent reversionary principle governing the validity of a lease.

Furthermore, paragraph 20 of the Guideline provides that “the Farmee has all the rights of the OML leaseholder in respect of the farm-out area.” Also the “Farmee has the right and obligation to deal directly with the DPR and other administrative authorities as the new leaseholder; and all rights, interests, obligations and liabilities of the Farmor in respect of the farm-out area containing the Fields automatically transfer to the Farmee and the Farmor is relieved of the same as from the date of the execution of the Farm-out Agreement.”

Paragraph 20 suggests that a Marginal Field is treated as separate and distinct from an OML. The

Farmee more or less can be said to be conferred with a legal title which is distinct from that of the Farmor. Furthermore, the consent of the President to a farm-out agreement between an OML holder and the Marginal Field Operator under the Act also supports this conferment of legal title.

It has been argued that because of certain clauses in farm-out agreements, a Farmee is a Sub-lessee, thus, the Farmor by implication is the legal owner of the Marginal Field and not the Farmee. However, this argument seems to be defeated wholly by the fact that Marginal Fields are not solely governed by the agreement of contracting parties but also regulated by the provisions of legislation, the guidelines and the practice and directives of the DPR in connection with the guidelines.

The Fiscal Regime of Marginal Fields in Nigeria

Nigeria’s fiscal regimes, consisting of Joint Ventures (JVs), Production Sharing Agreements (PSAs) and Service Contracts are derived from the *Petroleum Profits Tax Act* of 1959, its several amendments and contracts between the Nigerian National Petroleum Corporation (NNPC) and operating companies.⁸ Of the regimes, PSAs, and the consequent Production Sharing Contracts (PSCs) are applicable to marginal concessions.⁹ The PSCs are composed of instruments such as; bonuses, rentals, royalty and Petroleum Profit Tax (PPT), with the application of ring fencing and cost recovery, in addition to investment allowances and obligations imposed on operators.

The Fiscal Regime of the United Kingdom Continental Shelf (UKCS)

The key enactment establishing the UKCS fiscal regime is the *Oil Taxation Act 1975*. The regime was formulated with the government objective of “securing a fairer share of profits for the nation and

⁸Feso B: *Nigerian Marginal Fields: Navigating through Financial Storms* available at

<http://www.themixoilandwater.com/2011/05/nigerian-marginal-fields-navigating.html>

⁹Ibid

ensuring a suitable return for oil companies on their capital investment.”¹⁰ From inception the regime consisted of three main instruments, making it a royalty/tax system, namely: Royalty, Petroleum Revenue Tax (PRT) and Corporation Tax (CT).

Comparative analysis of the Fiscal Regimes: Nigeria and United Kingdom

An analysis of the Marginal Field's fiscal regimes in the UK and Nigeria is given consideration with reference to their neutrality, stability, risk and profit sharing on the backdrop of an evaluation of their attractiveness.

Neutrality

The Nigerian system whereby royalty instrument is retained by the PSC demonstrates non-neutrality when compared to that of the UK.¹¹ Non-neutral fiscal tools act as disincentives to investments as they negatively distort the relatively unfavorable project¹² revenue profile of Marginal Field development projects. The most significant effect of their influence is the delay to the relevant project's payback.

The UK achieved complete neutrality since January 2003 with the abolition of royalty payments. This is due to its existing fiscal tools (PRT and CT) being solely focused on profit for their assessment.

Stability

A review of the UK regime shows it's been adapted in response to economic influences and not arbitrarily.¹³ The UK government promises to continue this trend, anticipating a need for future adaptation to include Field maturity concerns.

However, stabilisation clauses are absent from the standard Nigerian Marginal PSC just as is the case

for the UKCS regime.¹⁴ The MFDP has been pursued at a time of high oil prices. Accordingly, any declaration regarding the government's propensity to promote stability for their development is speculative at best.

Risk sharing

Both the Nigerian PSC and the UKCS regime offer a capital cost uplift allowance in conjunction with accelerated depreciation.¹⁵ In isolation, these factors delay taxation, but the inclusion of royalty payments and bonuses may eclipse their impact. The UKCS regime is however more generous in terms of risk sharing than that of Nigeria's PSC as the UKCS's regime uplift of 75% is greater than that of the Nigerian PSC in addition to its exclusion of bonuses.¹⁶ Furthermore, the narrow ring fence applied in Nigerian regime constrains any opportunity to offset costs, hindering an opportunity for risk sharing.

Profit share

It is difficult to determine which regime is more equitable in terms of profit sharing. The Nigerian government exacts a greater fraction of the mineral rent when compared to that of the UK.¹⁷ However, due to the significantly lower costs associated with Nigerian crude, its government take may be more equitable in absolute terms.¹⁸ On the other hand, the UKCS regime indicates a fourfold increase in UKCS costs in comparison, supporting arguments of larger rents from the Nigerian concession.

Recent developments in the operation of Marginal Fields in Nigeria

It is expected that with the passage of the Petroleum Industry Bill (PIB), the Marginal Field farm-in will be converted to outright acreage holdings. The PIB proposes that the IOCs give up areas currently being

¹⁰Paragraph 16A (1) of the Act

¹¹Akhigbe I: Ibid

¹²Ibid

¹³Ibid

¹⁴Ibid

¹⁵Ibid

¹⁶Ibid

¹⁷Ibid

¹⁸Ibid

operated by Marginal Field operators as opposed to the current operation where the IOCs receive some form of royalty from the IOGCs.

This proposition by the PIB is a welcome development as it would allow the Marginal Field operators acquire their own acreage and become masters over their own Fields under favourable royalty and tax provisions.¹⁹ The existing contracts with the IOCs were granted without implementing a modern acreage management which typically includes strong relinquishment practices, with particular reference to the 'drill or drop' system.²⁰ Consequently, the IOCs are 'sitting on' acreage, which by implication means no access to acreage for new investors.

Furthermore, it is anticipated that the PIB will give Nigerian IOGCs a competitive advantage in that they will be required to pay lower royalty (lower production in Marginal Fields), as well as benefiting from the 2010 landmark deregulation & indigenization of the industry.

Conclusion

With the huge reservoir of Marginal Fields in Nigeria²¹, it is undisputable that the exploitation of Marginal Fields would increase Nigeria's revenue as well as oil production. However, it is imperative that the Nigerian Government weighs its indigenization policies against the lack of financial and technological capabilities facing Nigerian IOGCs. Thus Nigerian IOGCs are encouraged to seek foreign technical partnerships to meet capacity and funding challenges.

¹⁹Feso B, *ibid*

²⁰This means that companies either carry out significant work on a new block or return the acreage to Government.

²¹Which is currently put at over 2.3 billion barrels of Stock Tank Oil Initially in Place (STOIP), spread over 183 Marginal Fields.

Furthermore, the IOGCs should be poised to leverage opportunities presented by the rapidly evolving legal framework of the upstream sector once the PIB is passed into law and IOCs are pressured to "give up" [Marginal Fields] or lose them.

NIGERIA'S ABUNDANT GAS RESERVES AND SHORTFALL IN ELECTRICITY: AN APPARENT CASE OF UNDER-UTILIZATION

Introduction

It is common knowledge in the international oil and gas industry that gas is gaining significant share in the global energy mix, and the World Bank estimates that the global demand for gas will outstrip oil by the year 2025.¹ Global demand for Liquefied Natural Gas (LNG) is set to rise by 9 % a year during the next decade with Nigeria playing a key role in supplies.

According to the BP Statistical Review of World Energy 2011, Nigeria has an estimated 187 Trillion Cubic Feet (Tcf) of proven natural gas reserves² as of December 2010, making it the ninth largest natural gas reserve holder in the world. The majority of the natural gas reserves are located in the Niger Delta region of the country. It has been said over time that Nigeria is a gas province with drops of oil in it.³ Experts estimate the country's gas life expectancy at over 100 years. The Nigerian National Petroleum

¹Opening address to the 143rd Meeting of the OPEC Conference on December 14, 2006 at <http://www.opec.org/opecna/Press%20Releases/2006/pr192006.htm>.

²According to the report, proven reserves are accepted to be those quantities that geological and engineering information indicates with reasonable certainty can be recovered in the future from known reservoirs under existing economic and operating conditions.

³Ugeh, P., Yar'adua: New Gas Policy Underway. At <http://allafrica.com/stories/200711270482.html>.



Corporation (NNPC), the country's national oil company estimates that its gas reserve could reach about 600trillion CF in 15 years with the commencement of focused gas exploration processes⁴. Presently however, due to limited infrastructure, the sector has been largely undeveloped. In 2010, excluding flared or recycled gas, natural gas production was 30.3 Billion Cubic Metres (Bcu) representing just 1.1% of total world production⁵.

The Gas Advantage

By harnessing its natural gas reserves, Nigeria could alone provide the energy needs for the West Africa sub-region; yet according to a data by the International Energy Agency for 2009, electrification rates for Nigeria stood at 50%, indicating that approximately 76 million people do not have access to electricity. The World Bank data on the amount of gas flared in Nigeria indicates this wastage to be equivalent to the total annual power generation required in sub-Saharan Africa.⁶ Irrespective of the amount of gas reserves Nigeria has, electricity supply is at best epileptic throughout the country. Thus, this Newsletter examines reforms by the Federal Government of Nigeria towards correcting the abnormality of vast gas reserves against shortage of electricity in the country.

Power Generation

Power generation is one of the oldest and major methods of utilizing gas, yet Nigeria with its abundant gas reserves is known for regular power outage.⁷ The situation is such that the country has a

⁴African Crisis: "Nigeria; ExxonMobil Forecasts Gas Surpassing Coal by 2012". Online newspaper, February 2, 2011 at www.african-crisis.co.za/article.php?ID=90019&

⁶Public Policy for the Private Sector, October 2004.

⁷Yusuf, B: Nigeria- Nyanya-Gwandara Sends SOS on Power Outages on March 31, 2008 at <http://allafrica.com/stories/200803311166.html>

total installed generating capacity of about 5,600MW. However, for the past two decades, the actual generated capacity has hovered between 3,000MW and 4,000MW.⁸ As such, the level of electricity supplied to the nation is grossly insufficient and is far less than the base load demand and the installed capacity of many countries with far less population than Nigeria's.

The amount of electricity required for a developed and industrialized nation is estimated at 1,000 MW per 1 million people. Though, Nigeria is not a developed /industrialized nation, going by the estimate above, with a population of approximately 150 million people,⁹ Nigeria should be generating much more electricity than it currently generates in order to derive the optimum benefits derivable from having an efficient power industry. To resolve Nigeria's electricity power dilemma, the Federal Government adopted the National Electric Power Policy in 2001 with the intention of carrying out a comprehensive power reform. Till date not much has been achieved hitherto. Historically, attempts at revamping the problem ridden Nigerian Electricity Supply Industry¹⁰ (NESI) began as early as 1988 with the commercialization of the National Electric Power Authority (NEPA), now known as Power Holding Company of Nigeria (PHCN) and the upward review of tariffs. These efforts, however, hardly made any impact.

The Government has, since 1999, embarked on infrastructure rehabilitation and expansion programmes (which eventually led to the launch of the Nigerian Integrated Power Projects in 2005).

⁸Roadmap document for the Nigerian Electricity Supply Industry.

⁹Ayodele Oni: Domestic gas pricing and Electricity mismatch: A case for Adjustments to attract Private Sector at sdayonline.com/NG/index.php/law/legal-insight/26440

¹⁰Ibid

Subsequently the Federal Government began the reform process with the enactment of the Electric Power Sector Reform Act (EPSRA) 2005, which transitioned the then NEPA into PHCN. The key objectives of the EPSRA includes the liberalization of the power sector, the privatization of the key assets of PHCN, the promotion of independent power generation initiatives, and the development of a viable wholesale electricity market over time.

Given the vast amount of gas reserves Nigeria has, the country still suffers from electricity shortage. Inadequate gas infrastructure and several other commercial issues have been tagged reasons for this power shortage in Nigeria. Hence, the steady increase in diesel consumption as an alternative source for power generation both in private homes and for industrial purposes the resultant effect of which is the dearth of power in industries which ordinarily would thrive better with constant power supply.

Majority of power generation in Nigeria is derived from either thermal or hydropower¹¹. The two principal consumers of natural gas in Nigeria are the power and industrial sectors (including cement, fertilizer, manufacturing, aluminum and steel industries) as there is little or no natural gas supply for household purposes in Nigeria. Current power projections reveal that gas has a very prominent role to play presently. The largest single domestic consumer of gas is the utility company, PHCN¹² with 6 thermal power stations using gas as feedstock for power generation. As at 2008, Nigeria had 14 available generating plants, 11 thermal and three hydro plants with an installed capacity of 7876mw

¹¹Ernie, J., Oil & Gas Journal: *Natural Gas Offers Nigeria a Huge Potential Challenge*, (July 2, 2001).

¹²See Overview of Power Sector at <http://www.bpeng.org/CGI-BIN/companies/Infrastructure%20and%20Network/Power/N-EPA%20Power%20Holding%20of%20Nigeria.pdf>

but the available capacity is 4361mw while output is about 3000mw.¹³

The effect of this is incessant black outs within the nation, as only about 40% of the Nigerian populace have access to electricity.¹⁴ For a better grasp of this issue, it should be borne in mind that for economic development to occur, certain prerequisites must be on ground, availability of electricity being a fundamental one. This is why natural gas is envisaged as the fuel to power Nigeria's economy. Demand for natural gas in power generation is expected to rise as a result of the reforms in the Nigerian electricity sector. Independent Power Producing Companies (IPPs) are potential consumers of natural gas as it is used as feedstock for Combined Cycle Gas Turbines (CCGT). It has been proven that CCGT Turbines are more efficient.

In order to boost power generation via utilising gas, the Nigerian government in 2008 initiated the Nigerian Gas Master Plan (the "Master plan") part of which focused on developing gas to power. Thus both the Electricity Reform Policy and Nigerian Gas Master Plan are targeted at resolving the erratic power supply problems in Nigeria, whilst also prioritising the utilisation of the country's abundant gas resources.

The Gas Master Plan

In 2008, the Nigerian government introduced the Gas Master Plan set to largely address the issue of power shortage in Nigeria. The Master plan which is a guide for the commercial exploitation and management of

¹³Amanze-Nwachukwu, C., & Okwuonu, F., *Nigeria Electricity Tariffs to rise next month* on February 21, 2008 at <http://xymbollab.net/stories/200802210325.html>

¹⁴CWC Website at <http://www.cwcniif.com/index.php?page=infrastructure>

Nigeria's gas sector aims at growing the Nigerian economy with gas by pursuing 3 key strategies which entail stimulating the multiplier effect of gas in the domestic economy, positioning Nigeria competitively in high value export markets and guaranteeing the long term energy security in Nigeria. The Plan comprises of guidelines on the Domestic Supply Obligation Regulation, the Gas pricing policy, and the Nigerian Gas Infrastructure blueprint whilst placing emphasis on domestic market as opposed to exports.

The Domestic Gas Supply Obligation

The Domestic Supply Obligation¹⁵ is the first major attempt to refocus the gas resource for domestic use in Nigeria. It mandates producers of gas to set aside a certain pre-determined amount of gas reserves and production for supply to the domestic market.

The Domestic Supply Obligation Regulation is said to be coined from the Petroleum Act referred to as the incomplete bible of the Nigeria's Petroleum Industry¹⁶. Section 34 of the Second Schedule to the Act provides thus:

"If he considers it to be in the public interest, the Minister may impose on a license or lease to which this Schedule applies special terms and conditions not inconsistent with this Act including (without prejudice to the generality of the foregoing) terms and conditions as to;

(a) Participation by the Federal Government in the venture to which the license or lease relates, on terms to be negotiated between the Minister and the applicant for the licence or lease, and

¹⁵ Also termed the "Domestic Reserves Obligation"

¹⁶ Theresa Okenabrie: The Domestic Gas Supply Obligation: Is this the Final Solution to Power Failure in Nigeria? How can the Government make it work.

(b) Special provisions applying to any natural gas discovered, which provisions shall include-

(i) the right of the Federal Government to take natural gas produced with crude oil by the licensee or lessee free of cost at the flare or at an agreed cost and without payment of royalty;

(ii) the obligation of the licensee or lessee to obtain the approval of the Federal Government as to the price at which natural gas produced by the licensee or lessee (and not taken by the Federal Government) is sold and

(iii) a requirement for the payment by the licensee or lessee of royalty on natural gas produced and sold."

The aim of the Domestic Gas Obligation is to make gas available for the strategic domestic sector, especially for power generation. The obligation empowers the Honorable Minister of Energy (Gas) to stipulate the requisite amount of gas periodically for a period lasting about 5-7yrs by taking into consideration government's aspirations for the domestic economy ensuring that adequate gas resources are dedicated for rapid industrialization. The operators are expected to comply with the obligations or face a penalty of \$3.5/mcf for gas under-supplied, restricted export or both as the Minister of Energy may decide. The regulation also provides for the establishment of a Department of Gas within the Ministry of Energy that will oversee the execution of this regulation in conjunction with the Department of Petroleum Resources (DPR).

Gas Pricing Policy

The Master Plan also highlights the pricing policy which has key features such as the unequivocal commitment of the Federal Government of Nigeria towards making gas available and affordable within the domestic market. The International Oil Companies are to align their gas portfolios such that rich natural gas liquids (for which the dry gas is relatively cheaper) is to be directed to the domestic market, thus ensuring that Nigeria benefits from the

opulence of its gas by making it relatively more affordable for domestic use.

Furthermore, the Nigerian domestic market is grouped into 3 categories namely:

- (i) the strategic domestic sector, which provides power to residential and commercial users;
- (ii) the strategic industrial sector, responsible for gas supplies as feedstock in the creation of new products e.g. fertilizer, methanol, Gas-To-Liquid projects; and
- (iii) the commercial sector, which handles supplies to various manufacturing and production companies as industrial fuel.

The referenced categorization is set to form the basis for the pricing framework which determines the floor price for the different sectors. Also embedded in the pricing policy is the establishment of a Strategic Gas Aggregator which would manage the demand and supply of gas in the domestic market and align the reserves obligation accordingly.

Gas Infrastructure Blueprint

The Gas Infrastructure Blueprint presents a plan for investment in gas infrastructure in Nigeria comprising the creation of 3 domestic central processing facilities at the Warri/Forcados area, Akwa Ibom/Calabar area and Obiafu area (north of Port Harcourt).

These central processing facilities will serve as the major gas hubs where wet gas from gas fields will be assembled, treated and processed. Liquefied Petroleum Gas (LPG) and condensates will be extracted at these facilities and the dry gas fed into a network of gas transmission lines. With this arrangement, more LPG will be available for domestic use and the recurrent problem of liquids ingress into pipelines which has continually

impacted on power supply is set to be permanently eradicated.

Also, three franchise areas will be delineated around the central processing facilities, thus only licensed investors within a franchise area will be allowed to develop and operate the facility, thereby preventing proliferation of gas facilities with attendant cost impacts.

The Blueprint further provides for the development of 3 major domestic gas transmission systems in Nigeria, namely; the Western System comprising the existing Escravos Lagos Pipeline System (ELPS) and a new offshore extension to Lagos; the first South-North gas transmission line set to take dry gas from the Akwa Ibom/Calabar facility to Ajaokuta, Abuja, Kano, Katsina and also serve the Eastern states of Anambra, Abia, Ebonyi, Ebonyi, Enugu and Imo; and an inter-connector that links the Eastern gas reserves centre with the other two transmission systems. The transmission infrastructure will enable the industrialization of the Eastern and Northern parts of Nigeria, and enable connectivity between the East, West and North, which currently does not exist. In addition, the system is developed as a grid, ensuring redundancy and multiple accesses to gas markets from any gas source.

Effect of Domestic Gas Obligation on current commercial contracts

In as much as the IOC's initially embraced the Domestic gas obligation, they have failed and or neglected to contribute their quota claiming that compliance with the said obligation will affect their long term export contracts. According to the IOC's, they have already committed their reserves into long term Gas Sales and Purchase Agreements with "Take and Pay" clauses and to breach these contracts is to jeopardize their businesses.¹⁷ The IOCs are of the

opinion that it is the duty of the Federal Government to first address the security challenges and the domestic gas supply infrastructure deficiency rather than compel profit-oriented, private entities to get involved when their returns on investment cannot be guaranteed.¹⁸

The IOCs further claim that they are not in the business of power production. This seems a paradox given that about a decade ago, before the long term gas contracts were signed, some oil majors, notably Mobil, Agip and Shell, as part of their plans to eliminate gas flares by 2008 and boost the power supply in the country, engaged the Federal Government in discussions on building power plants and using their substantial gas production as feed stock.¹⁹ The combined output from their proposals, set to be available within thirty six months if agreed by the Federal Government, was over 3,000MW of Greenfield power generation. The oil majors at the time also proposed to generate electricity at 2-3cents per kw/hr, using their own gas as feedstock, as against PHCN's generation cost of over 9cents per kw/hr. They proposed to sell electricity to PHCN at 4cents per kw/hr, which they hoped would increase over time, when the state entity will be compelled to pay market price for gas.²⁰ However, as a condition precedent, they demanded a Government guarantee that electricity transmitted to PHCN would be paid for. It was their contention at the time that PHCN was not even paying the very low price that was charged by NNPC for gas supplied to the entity for power generation and could therefore not be trusted to pay for electricity supplied.

Several options were proposed to offer this guarantee. One of such, being an undertaking by NNPC to allow them net-off their power supply bill against their Royalty/PPT obligations.²¹ The Federal Government however declined to give the guarantee and this stalled further negotiations. On the other

hand a single phase of the Agip project was actualized and came on stream within thirty six months. Agip has however not been paid for the power generated.²²

In practice, where a system is capacity short, the best way to attract investment into power generation sector is to grant investors licence to construct project on the basis of a Build Operate and Transfer (BOT) scheme. Under such scheme, investors will build and operate a project and sell the product to earn revenue as return on investment for a set period of time. Thereafter, the ownership of the project is transferred to the host government, and under a service contract the private entity will continue managing the facility.

The risk is thus allocated between the project and the buyer. A government guarantee will be required in the BOT scheme. This results from the poor credit rating of the state owned electricity supply company and the fact that there is no market and no other way to mitigate the risk as the only off-taker is the state owned entity.

Power Sector Reforms: Egypt

As at 2004, Egypt had installed generating capacity of 17.06 Gigawatts (GW) with set target to add 4.5 GW by 2007 and 8.38 GW by 2012. 84 % of Egypt's electric generating capacity is thermal (natural gas), with the remaining 16 percent hydroelectric. All oil-fired plants have been converted to run on natural gas as their primary fuel. Electricity demand has grown over the years necessitating the building of several new power plants. Currently the country has 7 regional state-owned power production and distribution companies, held by the Egyptian Electricity Authority (EEA).

In July 2000, the EEA was converted into a holding company, though still owned by the state. Egypt has privately-owned power plants currently under construction financed under Public-Private

Partnership (PPP) schemes. In 2001, the first PPP project, a gas-fired steam power plant with two 325-megawatt (MW) generating units, located at Sidi Kerir on the Gulf of Suez costing \$450 million, began commercial operation. Electricity from the plant is priced at 2.54 cents per kilowatt-hour reflecting a competitive market price. Competitive Price stems from the availability of cheap natural gas with the duration of operational license fixed at 20yrs for investors. Several other PPP projects on electricity generation are coming up progressively in line with population growth such as Electricite de France (EDF) with two gas-fired plants and a part-solar power plant at Kureimat.

Ghana:

Between 2000 to 2009, residential demand for electricity rose by 61%. Ghana's target to increase electricity generation is set at 65% to 3,600 MW by 2013. Power sector reform is directed at new private sector investments. In 1997, the Public Utilities Regulatory Commission (PURC) was set up in Ghana to set tariffs, policies and promote competition in the sector. The country's Grid Company was created to provide fair and open access to the transmission grid which has provided a clear legal and commercial basis for private sector power generation. Projected growth of Independent Power Producers was about 19% in 2000 to 31% of total power generation capacity in the country by 2013.

Transition from total reliance on hydroelectric power to gas-thermal fuel sources, promoted by the government.

The country has also invested in the West African Gas Pipeline (WAGP) to supply power plants in the country with cheap natural gas from Nigerian oil fields. This has further accelerated the trend towards building gas-fired thermal plants and by 2013, thermal power plants will, for the first time,

supersede hydroelectric power and account for 66% of total installed power generation capacity in the country.

Recommendations

- The Federal Government should create an enabling environment in the sub-sector for private sector investment confidence, more than just prioritizing the development of gas via reforms.
- Establishment of an independent regulator in the gas sub-sector to introduce and implement a market driven regulatory framework geared towards promoting full liberalization of the sub-sector.
- Gradual removal of subsidies to integrate economic and market driven prices for electricity to balance the interests of electricity producers/suppliers and consumers.
- The independent regulator should be transparent and flexible to avoid any form of regulatory capture.
- Establish Third-Party-Access (TPA) regulatory framework to allow access to the national grid by other parties without undue influence and costs.
- Fully liberalize all sectors of the electricity industry; generation, transmission, distribution, supply and metering with infinite possibilities for investors.
- Provide the required Federal Government guarantees and bonds to support and promote investors confidence on ROI.
- The Federal Government should set a barometer to measure success in the electricity sector under the following headings;

- Price of electricity
- Density and spread
- Efficiency
- Quality of service
- Growth of the sector
- Policy transformation and flexibility amongst others.

OVERVIEW OF THE NIGERIAN CONTENT DEVELOPMENT ACT 2010

Background

The Nigerian Oil and Gas Content Development Act (hereinafter referred to as the "Act") was promulgated on the 22nd of April, 2010.

There was no legislation wholly dedicated to the Nigerian content in the oil and gas industry prior to the enactment of this Act although pocket provisions existed like the Petroleum Act of 1969 and NNPC directives. The latter Act provided, amongst others, that the holder of an oil mining lease must within 10 years from the grant have employed at least 75% Nigerians in managerial, professional and supervisory grades. Also the Nigerian National Petroleum Corporation (NNPC) had short term temporary directives in respect of local content for the oil and gas industry. In fact the new Act is partially premised on the temporary directives of NNPC for the oil and gas industry in addition to other innovations. Apart from these facts, it is fair to state that some industry players have some local content policies and practices in place.

Definition

The Act defines the Nigerian content or "Local Content" as it is popularly called as the quantum of composite value added or created in the Nigerian economy by a systematic development of capacity and capabilities through the deliberate utilization of Nigerian human, material



resources and services in the Nigerian oil and gas industry.

The Nigerian content simply focuses on the promotion of value addition in Nigeria through the utilization of local raw materials, products and services in order to stimulate growth of indigenous capacity. The Act promotes a framework that guarantees active participation of Nigerians in the oil and gas industry without compromising standards. To this end, the Act requires that Nigerian indigenous operators be given first consideration when contracts are awarded for oil blocks, licenses and all projects; that service provided and goods manufactured in Nigeria be given priority or preference and finally that qualified Nigerians are considered first for employment and training.

Scope & Application

The Act applies to all the players in the oil and gas industry; such as Regulatory Authorities (including the Nigerian National Petroleum Corporation, the Department of Petroleum Resources, Ministry of Petroleum etc.), operators, contractors, subcontractors, alliance partners and other entities involved in any project, operation, activity or transaction in the Nigerian oil and gas industry. It applies to both Indigenous and Multinational oil companies.

As noted above, the Act requires that first consideration be given to Nigerian companies when contracts are awarded for oil blocks, licenses and all other projects. For this purpose, the Act defines a Nigerian company as one formed and registered in Nigeria under the Companies and Allied Matters Act 1990 with not less than 51% equity shares owned by Nigerians. The implication of this is that Multinational Oil companies such as Shell, ExxonMobil, Chevron, Agip, Petrobras, Total, Conoco,

and Statoil whose subsidiary companies are registered in Nigeria under CAMA but whose majority of equity shares lie with their holding companies abroad may not qualify as a Nigerian Indigenous company and will therefore not benefit from the concession of a first consideration.

However, the Act applies only to contracts entered into after 22nd April 2010. As such, contracts or agreements initiated prior to the commencement of the Act would not be affected by its provisions.

Key Provisions

The Act established a Nigerian Content Management Board (the "Board") that has the responsibility of overseeing the implementation of its provisions. The Board is however subject to the directions of the Minister of Petroleum.

Other key provisions of the Act are:

a) Local Content Plan

All players in the industry are required to submit a Nigerian Content Plan to the Board in bidding for any license, permit or interest before carrying out any project in the oil and gas industry. The Plan must demonstrate compliance with the Nigerian content requirements of the Act. The Board may conduct a public review or assessment of the Plan. It is however required to make a decision whether or not to issue a Certificate of Authorization to an operator within 30 days from the commencement of the review or assessment.

b) Bid Evaluation

The principle of bid evaluation based on the lowest bidder is waived under the Act so that where a Nigerian indigenous company has the capacity to execute a contract it will not be disqualified for the sole reason that it is not the lowest financial bidder provided the value does not exceed the lowest bid

price by 10%. The Act requires that where bids otherwise are within 1% of each other on a commercial level, the bid with the highest Nigerian content should be selected. The selected bid must have a local content level of at least 5% above its closest competitor.

c) Employment & Training Plan

An employment and training program is required for every project. To this end, there is a requirement for Nigerians to be considered first for employment and training in any project. Where such Nigerians cannot be employed for lack of training, the act requires that reasonable efforts be made to provide such training within or outside Nigeria. The Act makes provision for succession plan for every position not held by Nigerians. The plan must provide for Nigerians to understudy each incumbent expatriate for a maximum period of four years after which the position shall be transferred to a Nigerian. However, 5% of management positions are however to be held by expatriates to protect the interest of investors.

d) Labour Clause

Contracts with a total budget exceeding USD\$100 Million are to contain a labour clause mandating the use of a minimum percentage of Nigerian labour in specific cadres as may be stipulated by the Board. Nigerians are to occupy all junior and intermediate positions.

E) Research & Development Program

A research and development plan is required for all projects in order to promote education, attachment, training, research and development in relation to the oil and gas projects. The plan should be updated every six months. The Board shall review on a quarterly basis, the research and development activities of industry players.

f) Professional Services

The Act requires that professional services including legal, financial and insurance services be provided solely by Nigerian firms. Industry players are restricted from procuring offshore insurance covers without the written approval of the Nigerian Insurance Commission, whose duty it is to ensure that the Nigerian local capacity has been fully exhausted. This policy aligns with section 67 of the Insurance Act, 2003.

g) Petroleum E-marketplace

Innovations such as the E-marketplace which would serve as a virtual platform for buyers and sellers of goods and services in the oil and gas industry allowing speedy and transparent transactions is to be created by the Board.

h) Joint Qualification System

Another innovation is the Joint Qualification System (JQS), which would serve as the Industry databank of available capacities and capabilities in the Nigerian oil and gas industry is to be established by the Board.

Penalty for Non-compliance

The Act makes it an offence for an operator, contractor or subcontractor to engage in activities contrary to the Nigerian content provisions. Such operators, contractors or subcontractors may be liable on conviction to a fine of 5% of the project sum or risk having their projects cancelled.

Effect of the Act

The Act offers great opportunities for growth and expansion of Nigerian companies involved in the oil and gas industry. The Act is set to ensure skills development and capacity building within the Nigerian oil and gas sector. It is hoped that the innovative provisions including the E-marketplace and JQS will enhance transparency within the sector.

There are however some areas of concern especially

as the Act specifically excludes a retrospective application of any of its provision to contracts, arrangements, agreements or memorandum of understanding made prior to the commencement.

Conclusion

There is no doubt that the conscientious implementation of the Nigerian Content Act will greatly transform the Nigerian Oil and Gas Industry and bring about a win-win for all parties interested in the subject matter of the Act. The oil companies to which much obligation accrues under the legislation are already in a joint venture with the NNPC and have contributed in some ways in the review of the draft Bill leading to this Act. Moreover, most oil companies are quite familiar with the several requirements of local content development in Nigeria, in their home countries as well as in other places where they operate.

However, it is important that industry players are prepared for the challenges and changes that will result from the introduction of the Act. They are advised to secure the services of reputable Nigerian law firms and other professionals with expertise in the oil and gas industry to ensure all-round compliance with the new provisions and ensure provision of legal advice and guidance where necessary.

JOINT DEVELOPMENT AS AN APPROPRIATE LEGAL RESPONSE TO OVERLAPPING MARITIME CLAIMS

There is much ado about the significance of natural resources, particularly hydrocarbons, perceived as vital to States for strategic, economic and environmental reasons. Consequently, inter-State disputes are inevitable where hydrocarbon resources are located in areas without clear boundary delimitations. Disputes can also occur as a result of the possibility of hydrocarbon resources straddling boundary lines due to its fugacious character¹.

Land boundaries are pretty much easily defined, with each State restricted to its territorial sovereignty. Maritime boundaries on the other hand are not always clearly defined. Although the nineteenth and early twentieth centuries provide some examples of bilateral treaties establishing maritime boundaries, it was after the 1930 Codification Conference in The Hague and the coming into force of the various Laws of the Sea that State practice on the subject became substantial².

The 1982 United Nations Convention on the Law of

¹G. H. Blake and R. E. Swarbrick, *Hydrocarbons and International Boundaries: A Global Overview*; in G. Blake, *Boundaries and Energy: Problems and Prospect* (London: Kluwer Law International, 1998), 3.

²Tanja, Garard Jacob, *The Legal Determination of International Maritime Boundaries: The Progressive Development of Continental Shelf, EEZ and EEZ Law, 1990*, University of Groningen.
<http://irs.ub.rug.nl/ppn/05912508X>



the Sea (UNCLOS) which supersedes the UNCLOS 1958³ regulates the international maritime environment. The UNCLOS gives coastal States rights to maritime zones⁴, which can extend to a distance of 200 nautical miles or more from the baselines. These zones are known to be rich in natural resources. While this extension of jurisdiction has led to an increase in offshore hydrocarbon activities, it has created the problem of overlapping maritime boundaries resulting from the proximity of some coastal States to each other⁵.

The most prominent boundary disputes include the dispute in the East China involving China, Japan and Taiwan; in the South China concerning the Spratly Islands claimed by China, Taiwan⁶, Vietnam, Malaysia, Brunei and the Philippines⁷. There are also maritime disputes in the Gulf of Guinea⁸ and in the Middle American and Caribbean regions⁹. Cooperation on maritime issues by States is therefore very important in contributing to the maintenance of peace, security and economic well-being of all the nations of the world¹⁰.

This Newsletter aims to show the legal responses to UNCLOS 1982, Article 311.

⁴The Territorial Sea, Exclusive Economic Zone and the Continental Shelf.
⁵Yusuf, Yusuf Mohammad, Is Joint Development a Panacea for Maritime Boundary Disputes and For the Exploitation of Offshore Transboundary Petroleum Deposits?, IELR, 2009, 4, 130-137.

⁶On June 18, 2008 the Kyodo News Agency reported that China and Japan had announced that they had reached an agreement to jointly develop the gas fields in the disputed areas of the East China Sea. See "Profit over patriotism", at http://www.economist.com/world/asia/PrinterFriendly.cfm?story_d=11591458 [Accessed April 17, 2009]. See also Yusuf Mohammad, Fn.

⁷above.

⁸In relation to the dispute between China and Vietnam, the two countries have signed a delimitation agreement in respect of their maritime boundaries in the Gulf of Tonkin. This marks the first maritime boundary agreement that China has entered into with any of its neighbours.

⁹Nigeria, Cameroon, Equatorial Guinea, Gabon and Sao Tome and Principe. Nigeria is in joint development with Sao Tome and Principe and is currently negotiating a JDA with Cameroon.

¹⁰Example Nicaragua against Colombia and Honduras. See Yusuf Mohammad Fn. 6 above.

¹¹Maritime Claims and Boundaries GIS Database, www.maritimeboundaries.com/10974.html.

maritime boundary disputes: negotiation and other adversarial dispute resolution processes. The Nigeria-Cameroon case study is utilized, as well as Nigeria / Sao Tome & Principe joint development. Conclusion is further drawn advocating the concept of Joint Development Agreements (JDA) as an innovative and viable option in managing boundary disputes where natural resources are involved.

INTERNATIONAL LAW & THE USE OF THE SEA

Every coastal State has jurisdiction over the oceans and seas, the limits of which are defined by international laws and conventions. These limits are as set out in the UNCLOS (the "Convention") as maritime zones¹¹.

The UNCLOS III (1982) is the most comprehensive international regime regulating the rights and obligations of States in relation to the marine environment. Apart from the 127 States and other entities that have ratified the Convention, States that have signed but not ratified it are nevertheless obliged to refrain from acts which will defeat its object and purpose¹². It also prevents States from taking out reservations to any part of the Convention¹³.

Following UNCLOS 1982 and the emergence of the new maritime zones, the importance of maritime delimitation in international law increased extensively. These zones are each discussed below.

Baselines

As the starting point for the determination of a coastal State's maritime territory, the baseline is the low water mark closest to the shores of the coastal

¹¹The zones are: the Baselines, Territorial Sea, Contiguous Zone, Exclusive Economic Zone and Continental Shelf.

¹²R. R Churchill & A. V. Lowe, *The Law of the Sea*, third edition, 24.

¹³UNCLOS 1982, Article 309.

State¹⁴. Alternatively it may be an unlimited distance from permanently exposed land; provided that some portion of elevations exposed at low tide but covered at high tide (like mud flats) is within 12 nautical miles of permanently exposed land. Baselines can also connect Islands across a coast.

The baseline has the function of establishing from what points on the coast the outer limits of the different maritime zones are to be measured¹⁵. The waters towards the landward territory of the baseline are the *internal waters*¹⁶. While the baselines are the boundary between the internal waters and the territorial sea and other maritime zones, perhaps their more important relevance is their role in maritime boundary delimitation¹⁷ as the application of the equidistance rule of maritime delimitation logically begins from the baselines.

The Territorial Sea

The territorial sea is the marine territory making up 12 nautical miles from a coastal State's baseline. The sovereignty of a coastal State extends beyond its land territory and internal waters (and in the case of an archipelagic State, its archipelagic waters) to the territorial sea, the air space over the territorial sea and also its sea bed and subsoil¹⁹. Other States do however have a right of innocent passage through the territorial sea of any coastal State²⁰.

The Contiguous Zone

The contiguous zone is the area covering and not exceeding 24 nautical miles from the baseline from which the breadth of the territorial sea is

¹⁴UNCLOS 1982, Article 5.

¹⁵R. R. Churchill, & A. V. Lowe, *The Law of the Sea*, third edition, p.31.

¹⁶UNCLOS 1982, Article 8.

¹⁷Daniel J. Hollis, Tatjana Rosen; *The United Nations Convention on the Law of the Sea (UNCLOS) 1982*. *The Encyclopedia of the Earth* 2010, [http://www.eoearth.org/article/United_Nations_Convention_on_Law_of_the_Sea_\(UNCLOS\),_1982](http://www.eoearth.org/article/United_Nations_Convention_on_Law_of_the_Sea_(UNCLOS),_1982).

¹⁸UNCLOS 1982, Article 3.

¹⁹UNCLOS 1982, Article 2; See also Fn.15 above.

²⁰UNCLOS 1982, Article 17.

measured²¹. The coastal State has control of this area in order to prevent and punish the infringement of its customs, fiscal, immigration or sanitary laws and regulations in this zone²².

The Exclusive Economic Zone (EEZ)

The EEZ is the area that stretches but does not extend beyond 200 nautical miles from the baseline²³. Within its EEZ, a nation may among others, explore and exploit the natural resources (both living and inanimate) found both in the water and on the seabed, pass laws for the preservation and protection of the marine environment, and regulate fishing²⁴.

The world's EEZs are estimated to contain about 87% of all of the known and estimated hydrocarbon reserves (and almost all offshore mineral resources)²⁵, as well as almost 99% of the world's fisheries²⁶, which should motivate nations to work together for the sustainability of the oceans and their vital and limited living resources.

The Continental Shelf (CS)

The CS is a geological formation that occurs naturally, by the gentle sloping of the undersea plain between the above water portion of a landmass and the deep ocean²⁷. The CS and the EEZ are to some extent synonymous and coextensive with regards to the territory or marine reaches covered by both concepts (200nautical miles)²⁸. However, UNCLOS includes

²¹UNCLOS 1982, Article 33(2)

²²UNCLOS 1982, Article 33.

²³UNCLOS 1982, Article 57.

²⁴UNCLOS 1982, Articles 56, 61-64. See also, Daniel J. Hollis & Tatjana Rosen, Fn.17 above.

²⁵Daniel J. Hollis & Tatjana Rosen, Fn.17 above.

²⁶United Nations, *The United Nations Convention on the Law of the Sea (A Historical Perspective)*, available at http://www.un.org/Depts/los/convention_agreements/convention_historical_perspective.htm (accessed 9 June 2010), as cited in Daniel J. Hollis & Tatjana Rosen Fn.17 above.

²⁷Daniel J. Hollis & Tatjana Rosen Fn.17 above.

provisions for nations to lay claim to a CS that extends up to 350 nautical miles from the baselines²⁹.

The CS is host to most of the world's oceanic plant, aquatic as well as animal life and plays a vital role in energy production, from offshore oil and gas reserves to renewable energy resources³⁰. States have the sovereign right over natural resources in the CS as well as its living organisms³¹.

A coastal State's exercise of its rights over the continental shelf as conferred by international law does not affect the status of the superjacent waters of the continental shelf and of the airspace above it³². Thus the waters of the continental shelf retain the character of "high seas" and the vessels of all other States retain the right to move freely therein and above it³³.

Overlapping Boundary Issues

The significance of maritime boundaries in current international relations has grown with the expansion of national limits of maritime jurisdiction in the last fifty or sixty years³⁴. Currently 180 boundaries have been agreed upon, which is far less than an estimated 400 boundaries that potentially

exist, according to geographers³⁵.

Countries tend to relegate boundary-making in the absence of any incidents or natural resources³⁶. Conversely, when States have boundaries that are not clearly delineated, problems arise. Some of these include enforcement of national laws, nationality of people in the disputed area, navigation and occupational rights. Not only would immigration and customs laws be difficult to enforce in disputed territories, there will also be issues of jurisdiction for the punishment of offenders in these areas. Further, exercise of territorial jurisdiction would be dicey (positioning of military submarines for instance)³⁷.

Where overlapping maritime claims exist, the resultant uncertainty over jurisdiction may well complicate ocean resource management and environmental protection measures. Sustainable management³⁸ of such resources can be severely hampered through, at the very least, uncoordinated policies and, at the more severe end of the spectrum, potentially destructive and unsustainable competition for access to the resources in question³⁹. In addition, oil and gas resources have a migratory nature, making it possible to develop oil deposits "that extend to both sides of the boundary of a continental shelf" from one side of "the boundary"⁴⁰. This can escalate to open conflict.

In effect, bilateral relations between States may easily be affected, subsequently resulting in a breach in international peace and security⁴¹. Such disputes may

²⁹Igiehon Mark Osa, Present International Law on Delimitation of the Continental Shelf, IELTR, 2006, 208-215. See also, UNCLOS 1982, Article 76 (1).

³⁰UNCLOS 1982, Article 76 (5).

³¹OCS Alternative Energy and Alternative Use Programmatic EIS, The Outer Continental Shelf, available at <http://ocsenergy.anl.gov/guide/ocs/index.cfm> (accessed 14 June 2010); Department of the Navy Office of Naval Research, Ocean Regions: Ocean Floor - Continental Margin & Rise, available at <http://www.onr.navy.mil/focus/ocean/regions/oceanfloor2.htm> (accessed 14 June 2010); as cited in Daniel J. Hollis & Tatjana Rosen, Fn. 17 above.

³²However, any extension beyond 200 nautical miles must be done within 10 years of UNCLOS coming into force for that particular state. See UNCLOS 1982, Annex II, Article 4.

³³Igiehon Mark Osa, See Fn. 28 above.

³⁴Igiehon Mark Osa. See Fn.28 above.

³⁵Anderson David: "Methods of Resolving Maritime Boundary Disputes". Introductory Paper; Chatham House International Law Discussion Group, 2006, 1.

³⁶Anderson David, see Fn. 34 above.

³⁷An example of this is the citing of the Nigerian Eastern Naval Command in the disputed area of bakassi. The question then is what happens to the command in light of the ICJ decision ceding the region to Cameroun.

³⁸Clive Schofield (2009) "Blurring the Lines? Maritime Joint Development and the Cooperative Management of Ocean Resources," *Issues in Legal Scholarship*: Vol. 8 : Iss. 1 (Frontier Issues in Ocean Law: Marine Resources, Maritime Boundaries, and the Law of the Sea), Article 3.

³⁹Clive Schofield, see Fn. 38 above.

⁴⁰North Sea Continental Shelf Cases, ICJ Reports (1969) 3, at 51, para. 97.

also lead to open violence, and delayed economic development in overlapping maritime areas⁴². In addition, trespassing on a State's claims could have serious consequences of fines, arrests, ship confiscation, prison, loss of limb or loss of life⁴³.

These issues which arise in overlapping territorial areas are rendered immaterial by demarcating the boundaries. In the alternative, these issues can be more efficiently managed by mutual agreement between the States or by State parties choosing to utilize other dispute resolution mechanisms⁴⁴.

Methods of Resolving Boundary Dispute

The resolution of maritime boundary disputes may be classified into two broad ways.

Negotiation with a view to executing Boundary Agreements or Treaties:

This may take a considerably long time, invariably halting the exploitation of the disputed areas. For example, it took Russia and Norway 40 years to negotiate and agree on a Boundary Treaty⁴⁵. Negotiation could also lead to innovations such as the JDA which would be explained in more detail below.

Adversarial dispute resolution mechanisms:

These include litigation, arbitration, and mediation, through international bodies such as the International Court of Justice (ICJ) and the

Permanent Court of Arbitration, to demarcate the boundaries in line with UNCLOS 1982 and other international law principles.

These methods impose protracted wait on the parties for which there is no guarantee that the outcome would be favourable and acceptable to both parties.

Nigeria v. Cameroon

Nigeria and Cameroon have had an age long territorial dispute (over Bakassi and Lake Chad) almost culminating in a war in 1981. The dispute was however referred to the International Court of Justice ("ICJ") by Cameroon in 1994 in what turned out to be an extremely complex litigation requiring the review of diplomatic exchanges dating back over a hundred years. The ICJ delivered its judgment in 2002 ceding the oil rich Bakassi to Cameroon.

Nigeria initially did not accept this decision. However the UN intervened as mediator and chaired a tripartite summit with the two countries which established a commission to facilitate the peaceful implementation of the ICJ's judgment.

Further to the foregoing, Nigeria signed an agreement with Cameroon in 2010 to jointly develop several hydrocarbon fields located along their maritime boundary⁴⁶. A complex land and maritime legal battle at the ICJ could have been averted by employing other appropriate dispute resolution mechanisms, which would have seen both countries with better diplomatic relations as well as mutually

⁴¹Nugza Dundua, The Delimitation of Maritime Boundaries Between Adjacent States, 1. http://www.un.org/Depts/los/nippon/unff_programme_home/fellows_pages/fellows_papers/dundua_0607_georgia.pdf

⁴²Charney Jonathan, Alexander M. Lewis; International Maritime Boundaries, Vol I, p. XXVII.

⁴³Maritime Claims and Boundaries GIS Database, www.maritimeboundaries.com/10974.html.

⁴⁴See UNCLOS 1982, Part XV, Articles 279-299 for dispute resolution mechanisms.

⁴⁵The New York Times; http://www.nytimes.com/2010/09/16/world/europe/16russia.html?_r=1

⁴⁶International Boundaries Research Unit, Durham University; https://www.dur.ac.uk/ibru/news/boundary_news/?itemno=11734&rehref=%2Fibru%2Fnews%2F&resubj=Boundary+news%20Headlines. Last visited August 2012.

benefitting from the resources in the overlapping boundary.

Therefore, where there are natural resources to be tapped and the States have no desire to wait for boundary delimitation in order to exploit these resources, a JDA becomes a more commercially expedient option.

THE CONCEPT OF JOINT DEVELOPMENT

Joint development is a procedure under which boundary disputes are set aside, without prejudice to the validity of the conflicting claims, and the interested States agree, instead, to jointly exploit, explore, and produce any hydrocarbons found in the area subject to overlapping claims⁴⁷.

JDA's differ slightly from Unitization Agreements which become apt only where maritime boundaries are clearly defined with the hydrocarbon deposits straddling the territory of two or more neighbouring States. However, Unitization Agreements are not within the purview of the newsletter, as the focus is on JDA and its relevance to States without clearly defined boundaries.

JDA's derive their legal validity from the UNCLOS which encourages parties to make "provisional arrangement of a practical nature" during the transitional period so as not to hamper the reaching of a final agreement on delimitation⁴⁸. The form of this "provisional arrangements" is not indicated in the UNCLOS, hence, the parties are at liberty to choose any mutually acceptable form of arrangement in accordance with principles of international law on peace and cooperation.

⁴⁷Ibrahim F. I. Shihata and William T. Onorato, "Joint Development of International Petroleum Resources in Undefined and Disputed Areas", in *Boundaries and Energy: Problems and Prospects*, eds. Gerald Blake and others (Boston /London/ The Hague: Kluwer Law International, 1998), 433.

⁴⁸UNCLOS 1982, Articles 74 and 83, paragraph 3.

The ICJ provides an additional basis for joint development of resources in JDZs in the North Sea Continental Shelf cases stating:

*"if...the delimitation leaves to the Parties areas that overlap, there are to be divided between them in agreed proportions or failing agreement, equally, unless they decide on a regime of joint jurisdiction, use, or exploitation for the zone of overlap or any part of them."*⁴⁹

Furthermore, the United Nations General Assembly Resolution considers it necessary to ensure effective cooperation between countries through the establishment of adequate international standards for the conservation and the harmonious exploitation of natural resources common to two or more States⁵⁰. The concept was also endorsed by an Arbitral Tribunal in *Eritrea vs. Yemen*⁵¹, and by the Arbitral Tribunal in *Guyana vs. Suriname*⁵², adding that the parties also had an obligation to negotiate in good faith.

JDA's have gradually become a part of international commercial practice in relation to both disputed and undisputed areas⁵³. In practice, the creation of a JDA constitutes an effective provisional arrangement

⁴⁹North Sea Continental Shelf Cases, judgement of 20 February 1969, International Court of Justice Reports 1969, 3; as cited in Nguyen Hong Thao, *Joint Development in the Gulf of Thailand*, http://www.dur.ac.uk/resources/ibru/publications/full/bsb7-3_thao.pdf, at p. 85.

⁵⁰UNGA Res. 3129 (XXVIII), UN GAOR, 28th Session, Supp. No.30 at 49 UN Doc. A/9030 at p.233. as cited in Yusuf, Yusuf Mohammad, *Is Joint Development a Panacea for Maritime Boundary Disputes and for the Exploitation of Offshore Transboundary Petroleum Deposits?*, IELR, 2009, 4, 130-137, at 136.

⁵¹The Eritrea-Yemen Arbitration, Arbitral Tribunal Award of December 17, 1999 which is reproduced at (2001) 40 I.L.M. 983. It can also be accessed at [http://www.pca-cpa.org/upload/files/EY"PhaseII.PDF](http://www.pca-cpa.org/upload/files/EY%20PhaseII.PDF)[Accessed April 17, 2009].

⁵²Stephen Fietta, "Guyana/Suriname Award" (2008) 102 A.J.I.L. 119-128 and Yoshifumi Tanaka, "The Guyana/Suriname Arbitration: A Commentary" (2007) 2(3) Hague Justice Journal 28. Both as cited in Yusuf, Yusuf Mohammad, see Fn. 50 above.

⁵³See Nguyen Hong Thao, *Joint Development in the Gulf of Thailand*, http://www.dur.ac.uk/resources/ibru/publications/full/bsb7-3_thao.pdf, at p. 85.

permitting countries to overcome territorial disputes while simultaneously facilitating the exploitation of natural resources in a transitional period⁵⁴. In the context of preventing any prejudicial exploitation and avoiding any waste by non-utilisation of natural resources, the application of a joint development regime for all or a portion of an overlapping area constitutes an attractive and agreeable measure pending a final delimitation⁵⁵.

JDA's are of three types.

The state parties may decide that one State manage the development of the hydrocarbons in the disputed area on behalf of both parties. The managing State subsequently pays an agreed proportion of the net revenue to the other State party⁵⁶.

Under the second model, a system of compulsory joint ventures between the States and their national (or nominated) oil companies is established⁵⁷.

The third model involves the establishment of a joint authority or commission with legal personality and the mandate to manage the JDZ on behalf of the State parties⁵⁸.

Features of JDA's

A model JDA shall as a matter of importance address issues such as: operatorship and the rules for selecting contractors, financial provisions/tax

⁵⁴Nguyen Hong Thao, See Fn.53 above at p.85.

⁵⁵Nguyen Hong Thao, See Fn. 53 above at p.85.

⁵⁶This method was chosen in the Bahrain-Saudi Agreement. See Ong David, Joint Development of Common Offshore Oil and Gas Deposits: Mere State Practice or customary International Law. 1999 American Journal of International Law, 771 at 788.

⁵⁷Example is the Japan-South Korea Agreement. See Ong David Fn. 56 above at 789.

⁵⁸See Ong David Fn.56 above at 791. An example is Nigeria-Sao Tome and Principe.

⁵⁹Ogunjofo Pius M.A; Managing Maritime Boundary Disputes Over the Continental Shelf in Oil and Gas, p.14 15, OGEL Vol 5 Issue 2, Published April 2007.

regime, management structure of the JDZ, net revenue sharing formula, as well as applicable law and dispute resolution mechanism⁵⁹. The JDA should also define the extent of the JDZ and a "Without Prejudice" clause showing that the arrangement is provisional pending a final delimitation of the boundaries⁶⁰. For a JDA to be successful, the parties must have a good degree of cooperation and good relationship between them, in addition to a willingness to negotiate in good faith.

NIGERIA AND SAO TOME & PRINCIPE

In addition to Nigeria Sao Tome & Principe (ST&P), a number of other countries have utilized JDA's in exploiting natural resources in disputing areas. Some of these include:

- Bahrain Saudi Arabia (1958)
- Iran Sharjah (1971)
- Japan South Korea (1974)
- Argentina United Kingdom (1995)

Nigeria and ST&P attempted negotiations with a view to delimiting overlapping boundaries in 1999, failing which a JDZ was established in 2000 with the consent and authorization of the Heads of State of both countries. After series of negotiation, the JD Treaty was signed on February 2001, ratified by the National Assembly of both countries and deposited at the United Nations⁶¹.

The treaty, which would last for a period of 45 years with a review after the first 30 years of its execution, describes the JDZ by coordinates and further provides for a 60 - 40 split of resources in the JDZ in favour of Nigeria. The JDZ is managed by a Joint Development Authority which reports to a Joint Ministerial Council ("JMC"). The JMC has

⁶⁰International Law Discussion Group, Chatham House, Feb 14 2006. <http://www.chathamhouse.org/publications/papers/view/108176>

⁶¹The Nigeria-ST&P Joint Development Authority website; <http://n-stpjda.com>

responsibility for all matters relating to the exploration and exploitation of resources in the JDZ, and such other functions as the State parties may entrust to it. The JDZ blocks are currently at the exploration phase.



Source: Nigeria St & P Joint Development Authority website

CONCLUSION AND RECOMMENDATION

Disputes linger as long as there are unresolved boundaries. Whether State parties choose to negotiate boundaries or settle before the ICJ, the process is time-consuming⁶². Maritime delimitation could assume very complex ramifications. Casualties may occur, diplomatic relations strained, and economic activities stunted because investors are reluctant to invest in high risk areas.

The past five decades have witnessed significant steps taken towards maritime cooperation in relation to areas of overlapping claims to maritime jurisdiction⁶³. Besides joint development, the other forms of provisional arrangements pending

delimitation are not based upon joint zones, but upon provisional lines or upon the de-facto boundaries⁶⁴. However, maritime JDZs have emerged as an important means to overcome deadlock in relation to maritime jurisdictional claims⁶⁵. The increasing number of JDAs and their geographical diversity emphasize its practicability and the preference it has acquired all over the world⁶⁶.

Establishing a JDZ and executing a JDA is not a panacea for resolving maritime disputes⁶⁷. However, it takes the pressure of drawing boundary lines off the parties who may be satisfied by a guaranteed share in the resources; instead of delimiting the boundaries and discovering that the resources are on "the wrong side" of the boundary. It took eight years for the ICJ to finally delimit the Cameroon-Nigeria boundary and hand over the oil rich Bakassi Peninsula to Cameroon. A 50-50 JDA over the disputed area would have benefitted Nigeria strategically and economically compared to the eight year power tussle at the ICJ. The ST&P JDA hence is an evidence of a lesson well learnt in this regard.

In almost all cases, once the management of the natural resources is taken care of, the bone of contention in overlapping boundaries disappears, making delimitation an easier task. By saving time and cost of litigation, as well as ensuring that resources are exploited in JDZs to the mutual benefit of the parties, a win-win result is achieved. Because JDAs can subsist for years, it can possibly outlast the need for States to subsequently delimit boundaries⁶⁸.

⁶³Clive Schofield (2009) "Blurring the Lines? Maritime Joint Development and the Cooperative Management of Ocean Resources," *Issues in Legal Scholarship*: Vol. 8: Iss. 1 (Frontier Issues in Ocean Law: Marine

Resources, Maritime Boundaries, and the Law of the Sea), Article 3.

⁶⁴Jianjun, Gao. "Joint Development in the East China Sea: Not an Easier Challenge than Delimitation". *The International Journal of Marine and Coastal Law* 23, no.1 (March 2008)

⁶⁵Clive Schofield, see Fn. 63 above at p.4.

⁶⁶Okafor Chidinma Bernadine, *Joint Development: An Alternative Legal Approach to Oil and Gas Exploitation in the Nigeria-Cameroon Maritime Boundary Dispute?*, *International Journal of Marine and Coastal Law*, 2006, p.489.

⁶⁷R.R Churchill, *Joint Development Zone: International Legal Issues*, in H. Fox ed, *Joint Development of Offshore Oil and Gas*, vol. 11 (London British Institute of International and Comparative Law 1990), 55 at 67.

⁶⁸Nguyen Hong Thao, *Joint Development in the Gulf of Thailand*, http://www.dur.ac.uk/resources/ibru/publications/full/bsb7-3_thao.pdf, at p. 86.

It must be mentioned that JDAs are not permanent solutions to maritime disputes, and do not guarantee cooperation among neighbouring States. The conclusion of any joint development arrangement, in the absence of the appropriate level of consent between the parties, is merely redrafting the problem and possibly complicating it further⁶⁹. However, the economic importance of hydrocarbon resources and the global hustle for energy security is a fantastic motivation for States to cooperate in JDZs as they are currently doing in the Arctic Region. By taking care of the energy resources which instigate State parties into pushing for maximum claims in boundary disputes, a JDA makes delimitation a much easier task, and hence is an effective legal response to managing overlapping maritime claims.

⁶⁹Stormont, W.G. and Townsend-Gault, I., "Offshore Petroleum Joint Development Arrangements: Functional Instrument? Compromise? Obligation?" in *The Peaceful Management of Transboundary Resources*, G.H. Blake, C.L. Sien, C.E.R. Grundy-Warr, M.A. Pratt, and C.H. Schofield, eds. (Graham and Trotman 1995), pp. 5176.

NIGERIA'S GAS TAX

INTRODUCTION

Research reveals that Nigeria is predominantly a gas province, which is a probable basis for the hydrocarbons being figuratively described as “gas with a drop of oil”. With a proven estimated reserve of 5.11 Trillion cu m, Nigeria has the 10th largest gas deposit in the world. The irony is therefore evident in the underdeveloped state of the gas industry as oil has been the hub of the country's hydrocarbon activities since the first discovery over 50 years ago.

Against this backdrop is the fiscal regime for gas activities, which is not expressly streamlined but is somewhat submerged within the oil fiscal regime. Needless to say that this has resulted in the loss of billions of dollars and unquantifiable opportunities over time for the Nigeria and Nigerians, especially as the oil and gas industry accounts for over 60% of country's revenue. Huge effort has been made in recent times to change this status quo culminating in the numerous on-going gas projects - the West Africa Gas Pipeline, Domestic Gas Market Expansion, Independent Power Plants, Liquefied Natural Gas Project, Tran-Saharan Gas Pipeline, among others. The overreaching effect to the industry of the Petroleum Industry Bill (“PIB”) when passed cannot also be ignored.

This Newsletter examines the current regulatory regime in force with respect to Nigerian Gas Tax,



concluding with an analysis of the possible expected changes with the eventual enactment of the PIB with respect to the subject.

THE TAX REGIME

The current legal and fiscal framework for the petroleum industry in Nigeria is geared toward oil production and utilization with very little focus on gas. However, upstream gas utilization projects are taxed under the Petroleum Profits Tax Act ('PPTA'), while downstream gas operations are taxed under the Companies Income Tax Act ('CITA').

The PPTA currently operates three different tax regimes for companies engaging in oil and gas activities depending on the type of contractual arrangement a company has. Petroleum Profits Tax ('PPT') is imposed at the rate of 85% of the company's chargeable profits and at the rate of 65.75% on companies that have not yet commenced sales or bulk disposal of chargeable oil as at April 1, 1977. Companies operating under a joint venture arrangement with NNPC have an applicable tax rate based on the terms of a Memorandum of Understanding between the operators and the Nigerian government, which is about 50% of chargeable profit whilst companies engaged in deep offshore operations under Production Sharing Contracts are taxed at the rate of 50% of chargeable profit.

Royalty is also charged at a graduated rate of 8% in areas beyond 1000 metres water depth, 10% for inland basins, and up to 20% in onshore areas of operations. Royalty payments for natural gas disposed under a Gas Sales Agreement ("GSA") however is tax deductible. In addition, while the value of natural gas disposed under a GSA would attract PPT, gas produced and *transferred* to gas-to-liquid facilities is at a 0% tax and 0% royalty rate.

Section 11 of the PPTA also sets out fairly extensive

incentives for upstream associated gas utilization operations.

- *Allowable Expenses for upstream operations* - Amounts invested in the separation of crude oil and gas from a reservoir into usable form are considered part of the oil field development and therefore treated as an allowable expense. This is a deduction additional to the allowable deduction for expenditure (including tangible costs) directly incurred in connection with drilling and appraisal of development wells. Although section 13(c) of the PPTA provides that capital employed in improvement, as distinct from repairs, is not an allowable deduction, capital investment on facilities and equipment used to deliver associated gas in usable form at utilisation or designated custody transfer points is treated, for tax purposes, as part of the capital investment for oil development and is therefore deductible.
- *Capital Allowances* - Tax assessment for the purposes of capital allowances is subject to the provisions of the PPTA and the terms of the revised MOU between the Federal Government and its joint venture partners. These allowances may be used to offset the company's crude oil income. Capital allowance at the rate of 20% per annum is given in the first four years, 19% in the fifth and sixth year and the remaining 1% in the books.

However, to prevent a reduction in taxable profits, the PPTA also provides conditions to which the companies must adhere in order to set a clear distinction on allowable deductible expenses. These are summarized hereunder.

- a. Condensates extracted and re-injected into the crude oil stream will be treated as oil (and therefore taxable as oil income) but condensate not re-injected will be "treated under existing tax arrangements" so that the PPTA incentives apply.
- b. The company must pay the minimum penalty charged by the Minister of Petroleum Resources for any gas flared by the company.
- c. The company must, where practicable, keep the expenses incurred in the utilisation of associated gas separate from those incurred on crude oil operations. Only expenses that cannot be separated will be allowed as a deduction against the company's crude oil income.
- d. Expenses identified as incurred exclusively in the utilisation of associated gas will be regarded as gas expenses and will only be allowable against the gas income and profit to be taxed under the CITA.
- e. Companies that invest in natural gas liquid extraction facilities to supply gas in usable form to downstream projects and other associated gas utilisation projects will benefit from the incentives.
- f. All capital investments relating to gas-to-liquids facilities will be treated as a chargeable capital allowance recoverable against crude oil income.
- g. Gas transferred from the natural gas liquid facility to the gas-to-liquids facilities shall be at 0% tax and 0% royalty.

Section 12 of the PPTA also makes the said incentives applicable to non associated gas. The implication as construed from the foregoing is that

where a company produces gas solely for the purpose of utilising such gas for a downstream project, the expenses incurred in connection with the production of that gas would be allowable against the income derived from the project for which such gas is utilised. This is because in such situations there would be no "gas production income" accruing to the company against which allowable gas production expenses could be offset.

Tax Regime of Downstream Gas Utilization Operations

CITA defines gas utilisation (downstream operations) as "the marketing and distribution of natural gas for commercial purposes, and includes power plant, liquefied natural gas plant, gas to liquid plant, fertiliser plant, gas transmission and distribution pipelines". Companies' income tax is charged at a rate of 30% on the assessable profits of a company engaged in downstream utilisation, subject to the application of the incentives specified in Section 39 of CITA. These incentives are summarized below.

- *Tax Holiday* - An initial tax-free period of three years beginning from production date, which may, subject to the satisfactory performance of the business, be renewed for an additional period of two years. In the alternative, a company may claim a 35% investment allowance on qualifying capital expenditure incurred in respect of the project, which allowance shall not reduce the value of the asset for purposes of computing capital allowances.
- *Tax Deductible Interest on loans* - Interest payable on any loan obtained for a gas project, with the prior approval of the Minister of Petroleum, is tax deductible.

- *Tax-free dividends* - Tax free dividends during the tax holiday, provided that the investment for the business was made in foreign currency; or that plant and machinery imported during the tax holiday was not less than 30% of the company's equity. Although not expressly stated in the CITA, it is important to note that where a company takes advantage of the 35% Investment Allowance in lieu of a tax holiday, dividends paid to investors during this period will not be tax free. This is further buttressed by the CITA which links the receipt of tax-free dividends, to the tax-free period.
- *Accelerated capital allowances* - After the tax holiday, the company can claim accelerated capital allowance of 90% with 10% retention, for investment in plant and machinery, and an additional investment allowance of 15% which shall not have the effect of reducing the value of the asset of the company. It is also important to note that a company which has opted for the 35% investment allowance under section 39(1)(b) cannot claim the additional 15% allowance under section 39(1)(c)(ii). Paragraph 16(2) of the Second Schedule to CITA gives the taxpayer the option of claiming such capital allowances before the asset is put to use, subject only to the taxpayer being able to establish to the satisfaction of the Board that the first use to which the asset will be put by the company incurring the expenditure will be for the purposes of the taxpayer's trade or business. The taxpayer may, in the alternative, elect to claim the capital

allowances with effect from the date on which such asset was first put to use.

- *VAT Exemption on Plant and Machinery*- As a further incentive, VAT exemption is granted in respect of plant and equipment purchased in connection with the utilisation of gas in downstream petroleum operations. Machinery, equipment or spare parts imported into Nigeria in connection with the processing of gas, or the conversion of such gas into electric power, is also exempted from customs duties.

The National Assembly is currently reviewing the extant fiscal regime via a proposed Petroleum Industry Bill ("PIB") which has been championed in part, to streamline industry operations and its tax regime. An attempt has been made to ensure the taxation laws in the industry are fair to companies and the government for each to fulfill its obligations to shareholders and society respectively. This discourse proceeds to assess critically, proposed taxation under the PIB.

TAXATION UNDER THE PROPOSED PETROLEUM INDUSTRY BILL

Part VII of the PIB makes provision for taxation of upstream gas operations which section 362 defines as the winning or obtaining of natural gas in Nigeria by or on behalf of a company on its own account for commercial purposes and shall include any activity or operation related to natural gas, including but not limited to the treatment of gas, that occurs up to the fiscal sales point or transfer to the downstream sector.

The PIB introduces the Nigerian Hydrocarbon Tax (NHT) which replaces the PPT. It is assessable on chargeable profits of a company's accounting period

at 50% for onshore and shallow water areas, and 25% for bitumen, frontier acreages and deep water areas. Where operations fall into geographical areas that are subject to different rates, the NHT will be assessed on proportionate parts of the operations. On allowable deductions provided in section 305, the PIB introduces the term 'reasonably' as a criterion for deductibility of expenses in computing NHT. The Bill does not include a test of reasonability thus subjecting the computation of a company's NHT to the interpretation of the Federal Inland Revenue Service.

Also, interest incurred on capital employed for upstream operations under a Production Sharing Contract (PSC) have been exempted from deductibility. It is difficult to determine the rationale for this exemption in view of the huge capital investment required in deep offshore operations. It is foreseeable that intending participants in PSCs may be wary of the impact of this harsh fiscal measure.

Further, section 306 lists deductions from the NHT that are disallowed. All general and administrative costs incurred outside Nigeria which exceed 1% of annual capital expenditure are not deductible. In paragraph (n), 20% of upstream expenses except for goods and services unavailable in Nigeria in the required quality and quantity are not deductible without the Nigerian Content Development Monitoring Board's (the Board) approval. Presumably, these provisions are intended to aid the development and use of local content. However, paragraph (n) raises concern as to the ease of doing business. It is possible for this paragraph to create an extra layer of red tape to corporate operations in Nigeria's upstream gas sector if the Board's approval is sought prior to incurring necessary expenses or thereafter as potential capital may be tied up in the NHT.

Nonetheless, the PIB in section 312 effectively removed the existing restriction on the 85% capital allowance that a company may claim on its assessable profits less 170% of its petroleum investment allowance. In addition, it provides in the Fifth Schedule for production allowance to be claimed as determined in consideration of production volume, water depth and specific price thresholds. The Schedule also separates the production allowance applicable to crude oil, natural gas and condensate production. It is arguable that the aim of these provisions is to encourage investment because companies are able to recoup their investment in a shorter time period.

The Fifth Schedule further provides general production allowance for qualifying companies. It is also computed based on production volumes and specific price thresholds. The allowance is available to companies in PSC arrangements for crude oil, natural gas and condensate production while companies engaged in a Joint Venture Agreement (JVA) with NNPC when the Bill becomes law will only qualify for the allowance on natural gas operations.

Section 197 of the Bill subjects the royalties payable by companies to the Minister's regulations. One may expect the computation of royalties to be based on production volume, water depth at operations and commodity prices. The flexibility is most probably to enable Government maximizes its revenue as section 353 also retains the application of the CITA to upstream operations.

Penalty for gas flaring is another issue left somewhat to the Minister's discretion. Sections 275-283 detail the prohibition of gas flaring and requires the Minister to specify a date for all glaring to cease and grant flaring permits to start-ups and in instances of equipment failure, shut down or safety flares. The penalty to be assessed on unpermitted flaring is a fine not less than the value of the gas flared. It is noteworthy that the Bill does not provide guidance to

the Minister on how to specify the value of flared gas. It is however commendable that section 306(k) stipulates that gas flaring penalty will not be a tax deductible expense.

CONCLUSION

There has been sustained agitation for signing the PIB to law. Several IOCs have expressed a stall in investments and other operations due to the seeming stalemate on the PIB. The Bill makes attempts to streamline taxation of petroleum operations and potentially increase Government revenue.

Although companies are permitted to enjoy general production allowances on natural gas operations under JVAs, the Bill leaves much to desire particularly with regard to capital allowances on PSCs and the requirement of NCDMB approval for expenses necessarily incurred in the course of business given Nigeria's current market of goods and services. It is hoped that such concerns will be addressed before the Bill becomes Law.



A large, light gray, stylized letter 'A' graphic that serves as a background for the page title. The 'A' is composed of a thick, rounded stroke with a white circular cutout in the center.

CASE LAW REVIEWS



**OWNERS OF THE MV “ARABELE” VS. NIGERIAN
AGRICULTURAL INSURANCE CORPORATION
(2008) 11 N.W.L.R (PART 1097) PAGE 183**

Introduction

The age long doctrine of *stare decisis* postulates that Courts, in the hierarchy of our Judicial Pyramid, are bound and should at all times hold themselves bound by the decisions of the Apex Court. The import of this in the Nigerian context is that all Courts are bound to follow the decisions of the Supreme Court with respect to all matters of similar or substantially similar facts. While this doctrine, on which hangs the balance of our jurisprudence, works to ensure consistency in the interpretation of laws and dispensation of justice, it could also, without a doubt, be a source of absurdity and entrenchment of injustice in the adjudication of disputes especially with respect to instances where the Apex Court has found and held itself as having erred in law in reaching certain decisions which have been followed as binding *stare decisis* prior to reversal by the same Apex Court.

In recognition of the fact that this age long doctrine of *stare decisis* may work injustice to the administration of justice, the Supreme Court has in a plethora of authorities upheld its powers, nay sacred obligation, to depart from precedents of its own previous erroneous decision. In the

case of **DAPIANLONG V. DARIYE**, the Court held thus:

“though the principle of judicial precedence or stare decisis is an indispensable foundation on which to decide what the law is, there may be occasions when a departure from



precedents is in the interest of justice and proper development of the law, and the Supreme Court recognises that it has the power to depart from precedent of its previous erroneous decisions on points of law."

This principle operates in Nigeria not just as a Common Law principle but as one to which recognition has been accorded by the Constitution of the Federal Republic of Nigeria.

It is in recognition of the powers of the Supreme Court (and we dare say a sacred duty/debt owed to justice) to depart from its previous erroneous decisions on points of law that this Newsletter seeks to critically examine the decision of the Supreme Court in the case of **OWNERS OF THE MV "ARABELA" VS. N.A.I.C.**, and ultimately draw the Courts attention to the need to revisit its decision and reverse same on points of law.

The Issues

For a proper appreciation of the object of our critical analysis in this Newsletter, it is imperative to identify the issues we seek to address in this discourse, to wit:

- i. *Whether Leave of Court is required to issue or serve an Originating Process from one Judicial Division of the Federal High Court to Another.*
- ii. *Whether Sections 97 and 98 of the Sheriffs and Civil Process Act apply to a Writ issued from one Judicial Division of the Federal High Court to another.*

In the case under review, the Federal High Court, Lagos Division (at first instance), the Court of Appeal and the Supreme Court answered both of these issues in the affirmative. It is attempted by this re-examination of the issues, to show the need for a revisit of the salient statutory principles involved. Particularly **Section 228 of the Constitution of the Federal Republic of Nigeria, Section 19 of the**

Federal High Court Act and Order 10 Rules 11, 12, 13 and 14 of the Federal High Court (Civil Procedure) Rules 1976 and Sections 97 & 98 of the Sheriffs and Civil Process Act.

The Facts

The facts relevant for our purpose is that the Plaintiff commenced a Suit by a Writ of Summons before the Federal High Court, Lagos Judicial Division against three Defendants whose address for service was given as Plot 452, Tafawa Balewa Way, Area 3 Garki, Abuja. One of the Defendants challenged the competence of the suit on the ground that under the rules of the Federal High Court applicable to the suit, leave of the Court was required to issue and serve the process on the Defendants who were not resident in Lagos but in Abuja. It was also contended that Section 97 of the Act applied to the suit thereby making it incompetent by reason of failure to make the endorsement on the Writ as required under Section 97 of the Act.

In sustaining the objection and dismissing the Plaintiff's suit, the Federal High Court of first instance per R.N. Ukeje J. made the following conclusion:

"From the endorsement in the summons for service, it is not in dispute that the 2nd Defendant has its address for service at Plot 452, Tafawa Balewa Way, Area 3 Garki, Abuja, a place outside the jurisdiction of the Federal High Court sitting in Lagos".

The Court of Appeal affirmed the decision of the Federal High Court on the point but substituted the order for dismissal with an order striking out the suit. The Supreme Court in the lead judgment of Ogbuagu JSC, proceeded on the following footing:

"I note that in paragraph 4.1 at page 3 of the Appellant's brief, it is conceded that it is not in dispute that the writ of summons was issued at the Federal High Court Registry, Lagos and was served on the Respondent in Abuja a place outside the jurisdiction of the Federal High Court sitting in Lagos, without the prior leave of

the trial Court being sought and obtained by the Appellant”.

Furthermore, the Supreme Court referring to the conclusion reached by the Court of first instance, said:

“That it is on this basis that it proceeded to apply the provisions of Sections 96, 97, 98 & 99 of the Sheriffs & Civil Process Act, CAP 407, Laws of the Federation of Nigeria, 1990 (hereinafter called “the Act”) and came to its decision to the effect that leave was required, to issue and serve the writ of summons on the Defendant/Respondent”.

The Discourse

The following salient questions arise therefore:

- i. *Is Abuja really outside the jurisdiction of the Federal High Court of Nigeria sitting in Lagos having regard to Section 19 of the Federal High Court Act?*
- ii. *Is the Federal High Court a State Court, so as to come under the purview of the provision of Sections 96, 97, 98 and 99 of the Sheriffs and Civil Process Act.*

The following extract from the judgment of the Court of Appeal, highlighted by the Supreme Court is very significant:

“I note also that in the Respondent's brief, it is stated that the said writ was to be served on the appellant (sic). It is also conceded by the Appellant in paragraph 4.2 of its brief that the Court below per Aderemi, JCA (as he then was) correctly, identified the issue for determination before it when it stated at page 184 last paragraph of the Record as follows:

“As shown in this appeal, it is the validity of the service of the writ of summons on the 2nd Defendant in the Court below and, who is now the Respondent before us that is being challenged”.

While there is no question raised concerning issuance of a Writ; it remains to be answered if leave

is needed to serve any process of any Court including the Federal High Court on anybody at any place within Nigeria?

We opine that no such leave is required. **Section 96 of the Act** clearly provides as follows:

“96(1) - A writ of summons issued out of or requiring the Defendant to appear at any Court of a State or the Capital Territory may be served on the Defendant in any other State or the Capital Territory.

(2) - Such service may, subject to any rules of Court which may be made under this Act, be effected in the same manner as if the writ was served on the Defendant in the State or the Capital Territory in which the writ was issued”

It is our position that the above cited provision clearly does not relate to a Writ issued from the Federal High Court. A careful read will reveal that the courts referred to are “any Court of a State or the Capital Territory”. The conclusion therefore reached by the three Courts in the Case under review calls for interpretation of **Section 19 of the FHC Act, Section 228 of the 1979 Constitution** (in force at the time the suit was commenced at the Federal High Court, Lagos Division) as well as **Order X Rules 11, 12, 13, and 14 of the Federal High Court (Civil Procedure) Rules, 1976**(in force at the time the suit was commenced at the Federal High Court, Lagos Division). It also calls for the interpretation of **Section 97 of the Act**. We now proceed to reproduce the salient provisions hereunder:

FEDERAL HIGH COURT ACT 1976:

19(1) - The Court shall have and exercise jurisdiction throughout the Federation and for that purpose the whole area of the of the Federation shall be divided by the Chief Judge in to such number of Judicial Divisions or part thereof by such name as he may deem fit.

(2) - For the more convenient despatch of business, the Court may sit in any one or more Judicial Division as

the Chief Judge may direct, and he may also direct one or more Judges to sit in any one or more of the Judicial Divisions

(3) - The Chief Judge shall determine the distribution of the business before the Court amongst the Judges thereof and may assign any judicial function to any Judge or Judges or in respect of a particular cause or matter in a Judicial Division.

FEDERAL HIGH COURT (CIVIL PROCEDURE) RULES, 1976

ORDER X RULES 11, 12, 13 & 14

11 - Where the suit is against a Defendant residing out of, but carrying on business within, the jurisdiction in his own name or under the name of a firm through an authorised agent, and such suit is limited to a cause of action which arose within the jurisdiction, the writ or document may be served by giving it to such agent, and such service shall be equivalent to personal service on such Defendant.

12 - Service out of the jurisdiction may be allowed by the Court whenever all or any part of the cause of action arose within the jurisdiction.

13 - Every application for an Order for leave to serve a writ notice on a Defendant out of the jurisdiction shall be supported by evidence by affidavit or otherwise, showing in what place or country such Defendant is or probably may be found, and the grounds upon which the application is made.

14 - Any order giving leave to effect service out of the jurisdiction shall prescribe the mode of service, and shall limit a time after such service within which such Defendant is to enter an appearance, such time to depend on the place or country where or within which the writ is to be served, and the Court may receive an affidavit or statutory declaration of such service having been effected as **prima facie** evidence thereof".

SECTION 228 OF THE 1979 CONSTITUTION

228(1) - There shall be a Federal High Court.

(2) - The Federal high Court shall consist of

(a) - a Chief Judge of the Federal High Court; and

(b) - such number of Judges of the Federal High Court as may be prescribed by an Act of the National Assembly.

SECTION 97 OF THE SHERIFFS AND CIVIL PROCESS ACT:

"Every writ of summons for service under this Part of the State or the Capital Territory in which it was issued shall, in addition to any other endorsement or notice required by the law of such State or the Capital Territory, have endorsed thereon a notice to the following effect (that is to say) "this summons (or as the case may be) is to be served out of theState (or as the case may be)and in theState (or as the case may be)."

The problem created by the decision of the Courts in the **OWNERS OF THE MV "ARABELA" VS. N.A.I.C.** is best exemplified by the decision of the Federal High Court in Suit No. **FHC/BAU/CS/03/09: ALL NIGERIA PEOPLES PARTY & ANOR. VS. HOUSE OF ASSEMBLY, BAUCHI STATE & 17 ORS,** (unreported judgment of Kolawole J, dated 21st July, 2009). In the said case, His Lordship, Honourable Justice Kolawole commented as follows:

"Judges of this Court have always expressed their reservations concerning the decision of Ogbuagu JSC in the said case because, the Federal High Court is only one Court with only one Chief Judge. The Court now has its Division in almost all the 36 States of the Federation and its Chief Judge can sit in any of the Judicial Division. I myself, was on a fiat issued by the Honourable Chief Judge, mandated, perhaps, "commandeered", to sit in this Division because of the urgency involved in this matter. By Section 19 of the Federal High Court Act, Cap. F. 12, LFN 2004, the Legislature provides thus: "The Court shall have and exercise jurisdiction throughout the Federation, and for that purpose, the whole area of the Federation shall be divided by the Chief Judge into such number

of Judicial Divisions or part thereof by such name as he may think fit". "It is in furtherance of this provision, that the Bauchi Division was opened in June, 2009 by the Chief Judge of the Federal High Court. Again, it is in furtherance of this provision, that the provision of Order 6 Rule 31 of the Federal High Court (Civil Procedure) Rules, 2009 to which the learned silk graciously adverted my attention to that "outside jurisdiction" was provided to mean, "out of the Federal Republic of Nigeria"... "The significance of the point I am driving at, perhaps, may be clearly made if it is considered that a process issued for instance, by the High Court of Justice, Bauchi Division was to be served in Katagun or Tafewa-Balewa Divisions all of which are the same High Court of Justice of Bauchi State under one single Chief Judge and leave to serve such processes is then required because, both Local Government Areas where the Divisions are located are regarded as being "outside jurisdiction". It is in this context that the Federal High Court which by Section 19 of its enabling Act is empowered to "exercise jurisdiction throughout the Federation" and for which purpose, "the whole area of the Federation shall be divided by the Chief Judge into such number of Judicial Divisions or part thereof by such name as he may think fit". So, in effect Bauchi Judicial Division is for the Federal High Court, just one of its Judicial Divisions as Katagun or Tafewa-Balewa which I have mentioned, are to the Bauchi State High Court of Justice. "It cannot be the law, that a Writ of Summons issued in Bauchi Division of the State High Court which is to be served in Katagun or in Tafewa-Balewa Judicial Divisions, will be required to go through the "rituals", if I may say so, of seeking and obtaining leave of the Bauchi Division pursuant to the Sheriffs and Civil Process Act under which the instant Motion Ex-parte is made, before the said Writ of Summons can be served in Katagun or in Tafewa-Balewa Judicial Divisions. I have read the revised edition of the Sheriffs and Civil Process Act supra, cited by the learned silk, I have no doubt that the omission of the Federal High Court as one of the Courts to which the said Act is applicable in this

regard, was not, for the Legislature, an accident. Being an Act of the National Assembly, I have no doubt that the Legislature had taken due cognizance of Section 19 of the Federal High Court Cap. F.12, LFN 2004 which itself, is another Act of the National Assembly. The analysis I have done so far, is to show why Judges of this Court have reservations of the Supreme Court in "**THE OWNERS OF MV ARABELLA VS. NIG. AGRICULTURAL INSURANCE CORPORATION** delivered on 16th May, 2008 and which has remained the judicial authority on which applications such as the instant Motion Ex parte dated 10/7/09 and filed on 13/7/09 are based...**As a Court of first instance, and in obedience to the Constitutional and judicial principle expressed as "stare decisis", this Court can only exercise its undoubted right to criticize such decisions of the appellate Courts, it is nevertheless, bound to apply them. The feelings of the Judge in such matter do not count"**.

The baseline is that the Federal High Court has no State jurisdiction but National jurisdiction even though Divisions of the Court exist in the States. Those Divisions are created for administrative purposes only and for the more convenient dispatch of the business of the Court. There is only one Federal High Court with jurisdiction all over Nigeria. The provision for leave for issuance and service of originating processes of the Court relate to processes for service outside Nigeria. **Order X Rules 11, 12, 13, and 14 of the extant Rules of the Federal High Court** must be read together with **Section 19 of the FHC Act** and when so read it is clear that out of jurisdiction within those Rules mean out of the Federal Republic of Nigeria. This is because every inch of Nigeria is within the jurisdiction of the Federal High Court of Nigeria. We humbly opine that the learned trial Judge in the **ARABELLA CASE** was clearly in error in thinking that Abuja is outside the jurisdiction of the Federal High Court sitting in Lagos and further opine that the Supreme Court was also in error in endorsing that view. The view shared by both Courts is clearly not consistent with the provisions of **Section 19(1) (3) of the FHC Act** and **Section 228 of**

the 1979 Constitution. See *ABIOLA VS. FRN (1995) 3 NWLR (PT. 382) 203.*

A critical reading of **Section 97 of the Act** also shows that the provision cannot apply to Writs of Summons issued out of the Registry of the Federal High Court. The Registry of the Federal High Court is one. Branches are merely provided in the Divisions for administrative convenience. It will be stretching common sense and reason, to infer that a Federal High Court Writ for Service in Nigeria is a Writ issued out of the State or the Capital Territory for service in another State in Nigeria. State High Courts as well as the High Court of the Federal Capital Territory have their territorial jurisdiction limited and delineated by the respective States and the Federal Capital Territory. Under the principle of Federalism, these High Courts have no jurisdiction outside of the States for which they are created. It is for this reason that processes issuing from those Courts for service outside the respective States are regarded as processes for service out of the territory of the respective states. This cannot apply to Federal High Court which has jurisdiction covering the entire land mass and territory of Nigeria.

It is hereby suggested that their Lordships erred in the above stated case wherein they posited that in serving a process out of the Registry of the Federal High Court, in a matter pending at the Federal High Court, there is a need to comply with the provisions of **Sections 97 and 98 of the Sheriff and Civil Process Act.** The said decision has brought to the front burner the issue of service of a process of the Federal High Court of Nigeria in any part of Nigeria, which forms the territorial jurisdiction of the Federal High Court. Since that judgement was delivered on May 16, 2008, it has raised so much dust within the legal community. It is hereby suggested that that decision calls for and indeed cries out loud for a review.

It is an elementary principle of law that the words of a statute should be given their literal and ordinary

meaning where they are devoid of ambiguity. In this case under discussion, the Supreme Court held that Sections 96 and 97 of the Sheriff and Civil Process Act apply to processes filed at the Federal High Court to be served anywhere in Nigeria outside the Division of the Federal High Court from which the writ is issued. This is clearly not the intendment of Sections 96, 97 and 98 of the Sheriffs and Civil Process Act.

The Writ of Summons in the Case under review was issued in the Lagos Division of the Federal High Court. Under Section 96 of the Act, service of the Writ does not require the leave of Court. A careful read of Section 97 of the Act reveals that every Writ of Summons for service out of the State or the Capital Territory in which it was issued shall in addition to any other endorsement or notice required by the law of such State or Capital Territory have endorsed thereon a notice to the effect stated. It is hereby suggested that the provision does not apply to the Federal High Court, such a Writ, being neither a writ issued out of a State nor out of the Federal Capital Territory for service out of the State or the Federal Capital Territory. It is rather a Writ issued in Nigeria for service in Nigeria.

It is crystal clear from Section 19 of the Federal High Court Act that the Federal High Court is conceived as one Court and is divided into the Judicial Divisions for administrative convenience only and also to make justice easily accessible to all citizens of Nigeria. To put it in other words, it is for this reason that there is no Federal High Court of Abuja or Federal High Court of Port Harcourt. It appears that there was a wholesale application of the Act to the Federal High Court notwithstanding the context and intendment of Sections 96, 97 and 98 of the Act. Neither Section 19(1) under Part 111 of the Sheriff and Civil Process Act which defines a Court to mean High Court of the Federal Capital Territory or of the State nor Section 95(1) under part VII of the same Act which defines Court to mean a Court to which Parts III, IV,V and VI apply, justifies the approach. The intention of the draftsman is clear. The rule of construction of Statutes is relevant here. Where a statute mentions specific

things or persons, the intention is that those not mentioned are not intended to be included. The principle is based on '**expressio unius est exclusio alterius**' that is the expression of one thing is the exclusion of another. In other words, the express mention of one thing in a statutory provision automatically excludes any other which otherwise would have applied by implication with regard to the same issue. See **SEC V. KASUMI (2009) 10 NWLR (PT 1150) CA 509 at 537 PARAS C-H.**

Sections 96, 97 and 98 of the Act clearly refer to High Court of a State and the High Court of the Federal Capital Territory. The Federal High Court is impliedly excluded in view of Section 228 of the 1979 Constitution which provides that there shall be a Federal High Court and Section 19(1) of the FHC Act, which makes the entire Nation the jurisdiction of that Court by providing that "**The court shall have and exercise jurisdiction throughout the Federation and for that purpose the whole area of the Federation shall be divided by the Chief Judge into such number of Judicial Divisions or part thereof by such name as he may deem fit**".

It is pertinent to state at this juncture that the decisions relied on by their Lordships in reaching the said decision are inapposite as they emanated from High Courts of States. First, the case of **NWABUEZE V. OBI-OKOYE** where the Apex Court decided on the basis of Anambra State High Court Rules which is to the effect that leave of Court must be first sought and obtained before a Defendant is served out of the jurisdiction of Anambra state. In that case, Justice Obi- Okoye instituted a suit against Professor Ben Nwabueze and the University Press Ibadan. The leave of Court was not sought to serve the Defendants in Ibadan, outside Anambra State. The Supreme Court in relying on the submission of Chief Rotimi Williams, SAN set aside the service of the Writ for non compliance with the provisions of the Sheriff and Civil Process Act.

One other case relied on by their Lordships of the Supreme Court is the case of **BELLO V. NATIONAL**

BANK OF NIGERIA. Here, the Court is the High Court of Kaduna State. The Court of Appeal held that Sections 96 and 97 of the Sheriff and Civil Process Act are applicable to Kaduna State for the purpose of requiring the Defendant to appear at a High Court of the state.

The Appellant relied on the case of **ABIOLA V. FEDERAL REPUBLIC OF NIGERIA** which their Lordships did not give so much attention to in arriving at their decision. The case dealt with the issue of whether Federal High Court is one and the same. In that case, Late Chief MKO Abiola was charged with the offence of treason. The sole issue for determination was the territorial jurisdiction of the Federal High Court over criminal matters. The Court of Appeal however made a general pronouncement to the effect that the Federal High Court is one Court. In that case at page 234 of the judgment, the Court of appeal opined thus:

"Plainly, the use of the word jurisdiction at the trial Court and this Court to describe the basis of the Appellant's objection to his trial by the Federal High Court sitting in Abuja appears to be out of place. This is because the Federal High Court in this Country irrespective of whether it sits in Port Harcourt, Lagos, Abuja, or even Maiduguri in Borno State, the jurisdiction of the Court is not restricted to any particular Judicial Division of the Court but across the entire Country. To this extent therefore it would be wrong therefore to talk of the jurisdiction of the Federal High Court in Lagos as distinct from the jurisdiction of the same Court in Abuja since it is one and the same Court".

It would have been apposite for the Federal High Court to have relied on the decision in **ABIOLA V. FRN** which is to the effect that Federal High Court is one. See also **IBORI V FRN (2009) 3 NWLR (PT 1128) CA 283.**

In this discourse, we are not oblivious of the provision of Order X Rule 14 of the Rules 1976 which is the

relevant rules of Court considered in the course of delivering the judgment. The rule provides:

“Any order giving leave to effect service out of jurisdiction shall prescribe the mode of service, and shall limit a time after such service within which such Defendant is to enter an appearance, such time to depend on the place or Country where or within which the writ is to be served, and the Court may receive an affidavit or statutory declaration of such service having been effected as prima facie proof thereof.”

Order X Rule 14 of the Rules ought to be read in the light of Section 19 (1) of the FHC Act and Section 228 of the 1976 Constitution and when so read, it becomes manifest that since the entire Nigeria is within the jurisdiction of the Federal High Court, “out of jurisdiction” in the context of the Federal High Court means out of Nigeria. A combined reading of Section 19 of the FHC Act with Order X rule 14 of the Rules 1976 would have led to the conclusion that no part of the entire nation Nigeria can be said to be out of the jurisdiction of the Federal High Court. A death knell was sounded on the 1976 Rules when the 2009 Rules provided specifically that service outside jurisdiction means service out of Nigeria.

Conclusion

With the hope that the Supreme Court will someday re-visit the decision in this case, we wish to refer to the dictum of an eminent Jurist of the Supreme Court Oputa JSC (as he then was) cited with approval by the Honourable Justice Aderemi JSC in the **DAPIANLONG V. DARIYE** (Supra) at pages 448 thus:

“we are infallible because we are final; but we are not final because we are infallible”

However, as we have sought to do by this Newsletter, let the decision in the Case under review not be final because my Lords are infallible; indeed,

we urge that my Lords, the Honourable Justices of the Supreme should reconsider their decision, depart from and overrule same when the opportunity presents itself because it is erroneous on points of law, this we submit is a sacred debt owed to justice.

THE BRIEF

**MARK V. EKE (2005) 5 N.W.L.R. (PART 865) PAGE 54
SERVICE OF COURT PROCESSES ON A COMPANY****Introduction**

One of the time honoured pillars upon which rest the concept of Justice is encapsulated in the Latin maxim, “*audi alteram partem*” which translated in simple English language means “*hear the other Party*”. This rule of natural justice ensures that equal opportunity and protection is afforded the competing interests and rights of the contending Parties. To achieve this, the Party commencing a suit placed before Court for adjudication has an obligation to ensure that all Processes filed by him, in the suit, get to the attention of the Defendant. Such is the importance of service of Court processes on the Defendant, that failure or omission to discharge this obligation to serve is an incurable vice that robs the Court of jurisdiction to hear and determine the matter and renders null and void all proceedings taken without service.

To underscore the foundational importance of “service” with respect to the jurisdiction of a Court to adjudicate upon a matter, the case of **UWAH PRINTERS (NIG.) LTD AND ANOTHER V. EMMANUEL UMOREN** is apposite, as the Court of Appeal held thus:

“Where service of process is required, failure to serve is a fundamental vice and the person

affected by the Order but not served with the process is entitled ex-debito justitiae to have the Order set aside as a nullity. Such an Order of nullity becomes a necessity because due service of process is a condition sine qua non to the hearing of any suit”.



Similarly, the Court held in the case of **Brigadier-General Remawa (Rtd) V. NACB Consultancy and Finance Company Limited and Another**, as follows:

“failure to serve process where the service of process of Court is required is a failure which goes to the root of the case. It is the service of the process of Court on the Defendant that confers on the Court the competence and the jurisdiction to adjudicate on the matter”

All Rules of Court make service of the processes issued from the Court's Registry a requirement and it is only when the said processes are served on the Defendant that the Court becomes seized of competence and jurisdiction to adjudicate the matter.

While the law seems settled on the issue of service of Court processes on a Defendant who is a human or natural person, same cannot be said of the law regarding service of Court processes on a Defendant who is a juristic person. This is particularly evident, as we shall soon see in the course of this discourse, by the obviously inconsistent and conflicting decisions of the Courts on the issue of service of Court processes on a Company.

This Newsletter is therefore intended to critically analyze the extant laws relating to service of Court processes on Companies and in particular review the decision of the Supreme Court of Nigeria in the case of **MARK VS. EKE (2004) 5 NWLR (PT. 865) 54**.

Review of relevant statutes

Until January 2, 1990 when the **COMPANIES AND ALLIED MATTERS ACT (“CAMA”)** came into operation, documents to be served on a Company incorporated under the Laws of Nigeria were served by leaving it at, or sending it by post to, the registered office of the Company. This was the prescribed mode of service under **SECTION 36 OF THE COMPANIES ORDINANCE OF 1968**, which provides as follows:

“A document may be served on a company by leaving it at, or sending it by registered post, to the registered office of the company”.

CAMA came into being on January 2, 1990 and **SECTION 651** thereof, repealed the 1968 Companies Ordinance. **SECTION 78 OF CAMA** was enacted in words and terms radically different from Section 36 of the repealed Companies Ordinance of 1968. It provided as follows:

“A Court process shall be served on a company in the manner provided by the Rules of Court and any other document may be served on a company by leaving it at, or sending it by post to the registered office or head office of the Company”

The following changes introduced by CAMA are to be noted:

- i. Section 36 of the Companies Ordinance of 1968 did not make a separate provision for service of a **court process** and a separate provision for service of **any other document**. Section 78 of CAMA did;
- ii. Section 36 of the Companies Ordinance 1968 did not contemplate service at **the Head Office** of a Company but Section 78 of CAMA drew a distinction between service at **the registered Office** of a Company and service at the **Head Office** of a Company and only with respect to **other documents other than a Court Process**;
- iii. Section 36 of the Companies Ordinance of 1968 applied the permissive **“may”**, while Section 78 of **CAMA** applied the mandatory **“shall”** to, service of Court Processes and applied the permissive **“may”** to, service of any other document.

In the light of Section 36 of the Companies Ordinance of 1968 and Section 78 of CAMA therefore, we now proceed to discuss the decision of the Supreme Court in **MARK VS. EKE**, based on the maxims of statutory interpretation that the Legislature does not use words in vain, and that the Court would not read words into a statute which are not expressed therein.

The Facts

The Suit, A/426/93: **GABRIEL EKE VS. KALU MARK & MAR-PRIK IND. NIG.LTD**, was commenced in 1993, that is, after the CAMA had come into being, and when the applicable Rules of Court was the Imo State High Court (Civil Procedure) Rules, 1988. MAR-PRIK IND. NIG.LTD, one of the Defendants was a Company registered in Nigeria and carrying on business in Aba. The Plaintiff commenced the Suit, which was placed on the Undeferred List, at the Aba Judicial Division of the High Court of Imo State (as it then was). The Plaintiff sought and obtained the leave of the Court to serve the Originating Processes on the Defendants by substituted means at No. 102 School Road, Aba. The Court was subsequently informed that the Defendants had been served with the Originating Process by substituted means and that the Defendants had disclosed no intention to defend the suit. Judgement was entered for the Plaintiff. The Plaintiff levied execution, whereupon the Defendants moved to set aside the Judgement on the ground that the Originating Process was not in fact served on them. The trial High Court held that service had been proved. The Court of Appeal affirmed. Reversing both the High Court and the Court of Appeal, the Supreme Court, in so far as the Company sued was concerned, correctly on the facts and in our humble view held that proper service was not proved. However the Supreme Court proceeded to record as follows:

“The Companies and Allied Matters Act, by section 78, makes provision as how to serve documents generally on any Company registered under it. By this, a Court process is served on a Company in the manner provided by the Rules of Court. A service on a

Company, as this provided must be at the Registered Office of the Company and it is therefore bad and ineffective if it is done at a branch office of the Company.” (P.79 G-H)

The Supreme Court cited the antiquated 1889 case of **WATKINS V. SCOTTISH IMPERIAL INSURANCE CO.**, as authority for this view.

The Discourse

We opine, quite firmly, that the views of the Supreme Court are not in line with the provision of Section 78 of CAMA. Unfortunately, some subordinate Courts have been constrained to follow the decision of the Supreme Court.

It is with profound deference that we suggest that the decision of the Supreme Court to the effect that the service of a Court process on a Company must be done at the Registered Office of the Company may have been justified under the provisions of the repealed Companies Ordinance of 1968 but not under section 78 of CAMA. That decision appears therefore to have been given per incuriam. Words are not imported into a statute, which are obviously not there. In the face of the express provision of section 78 of CAMA, it is not valid to delve into English Law of such great antiquity as the decision in **WATKINS V. SCOTTISH IMPERIAL INSURANCE CO.**

All documents other than Court processes **may** be served on a company by leaving it at, or sending it by post to the Registered Office or Head Office of the Company. But a Court Process **shall** be served on a company **in the manner provided by the Rules of Court**.

There is the cannon of statutory interpretation, to the effect that the Legislature does not use any words in a statute in vain, especially where the existing Law is altered and a radically different enactment is substituted. When a specific enactment is altered and replaced with another, an aid in the interpretation of the new enactment is to find out the mischief in the old Law, which the new Law set out to cure.

Under Section 36 of the 1968 Companies Ordinance, a Plaintiff, in order to effectively serve a Court process on a Company, needed to undertake a search at the Companies Registry to discover the Registered Office of the Company and probably obtain a Certified True Copy of the Certificate of Registration of the Registered Office before filling a suit against the Company even if the company carries on business and maintains presence and has an advertised business office within the Jurisdiction of the forum Court, and had transacted the business given rise to the suit with the Plaintiff within that jurisdiction. An Insurance Company may have its Registered Office in Yola, but may carry on business at Ikom in Cross-River State where it maintains an advertised office from which it transacts Insurance business with persons and business enterprises based in Ikom. When the Company fails to pay a claim in Ikom and a suit is filed against it in Ikom, the Plaintiff must take the trouble to obtain the leave of the Court to issue and serve the Originating Processes on the Company at the Company's registered office in Yola or otherwise take the risk of sending the processes by post.

This is the same for a Bank which has its registered office in Lagos but maintains a branch office in Obolo-afor in Enugu State. In such cases, the Defendant could frustrate a suit merely because service was effected at its advertised branch office or even at its Head Office instead of at its Registered Office.

The hardship created by this clumsy procedure was the mischief which the Legislature identified and set out to cure by section 78 of CAMA, by liberalizing the mode of service of Court Processes on Companies, bringing it in line with the Rules for service made for each Court. It is noteworthy that since section 78 of CAMA was introduced, various Courts have adopted modes of service suitable to them and different from section 36 of the Companies Ordinance 1968.

The "Rules of Court" means the Rules of the Court from which the process is issued. However, as the various Courts have different rules for service of Court processes, we shall review the Supreme Court Rules, the Rules of the Federal High Court, the Rules of the High Court of the Federal Capital Territory Abuja, the Lagos State High Court Rules and the Imo State High Court (Civil Procedure) Rules 1988, in operation when **MARK V. EKE** was commenced.

The Supreme Court

Service of Court process on a Company from the Supreme Court seldom arises for obvious reasons. By the time proceedings arrive at the Supreme Court, the respective Parties addresses for service had crystallized. A Limited Liability Company is most unlikely to become a Party to a proceeding at the Supreme Court in a matter within the original jurisdiction of the Court. With regard to the Appellate jurisdiction of the Supreme Court, **ORDER 2 RULE 3(1)(B)** of the Supreme Court Rules requires only the Notice of Appeal to be served personally, and Order 2 Rule 3(2) of the same Rule provide that personal service is to be in the manner obtainable at the Federal High Court.

Federal High Court (Civil Procedure) Rules 2009

Order 6 Rule 8 FHC Rules provides:

"When the suit is against a Corporation or a Company authorized to sue and be sued in its name or in the name of an officer or Trustee, the writ or other document may be served, subject to the enactment establishing that Corporation or Company or under which the Company is registered as the case may be, by giving the writ or document to any Director, Secretary, or other Principal officer, or by leaving it at the Office of the Corporation or Company"

The Rules of Court have statutory effect and since it must be accepted as an axiom that the Legislature does not use a word in vain, it follows that by avoiding the use of the words "**Registered Office**"

and using instead the word “**Office**”, the Rule maker really intended what he said, that is, that service may be effected at any office of the Company.

This issue came up and was admirably dealt with by the Court of Appeal in **BELLO VS.NBN** as follows:

“Section 78 of the Companies and Allied Matters Act, 1990, Cap. 59, LFN 1990 provides for services of documents on companies as follows:

“A Court process shall be served on a company in the manner provided by the Rules of Court and any other document may be served on a company by leaving it at, or sending it by post to, the registered office or head office of the company.”

This should be contrasted with the position under the former Companies Act, 1968 which provides that:

“A document may be served on a company by leaving it at, or sending it by post, to the registered office of the company.”

Obviously, the 1990 Act has elongated the former provisions for service of documents on companies. Two crucial distinctions characterize the 1990 Act. First the 1990 Act discriminates between service of a Court process and any other document. Second, the 1990 Act clearly provides for service of a Court process to be effected in accordance with the domestic local provisions of the Rules of each State High Court. The domestic or local Rule with relation to Kaduna State, as far as it relates to service on companies and corporate bodies, is Order 12 Rule 8 of the Kaduna State High Court (Civil Procedure) Rules, 1987. It states as follows:

“When the suit is against a corporation or a company authorized to sue or be sued in its name or in the name of an officer or trustee, the writ or other document may be served, subject to the enactment establishing such corporation or company or under which it is registered as the case may be, by giving same to any director, secretary or other principal

officer or by leaving it at the office of the corporation or company.

It follows that under the provisions of Rule 8, a corporation or a company can be validly and effectively served with a Court process, subject to the 1990 Act which establishes the company or corporation, by giving it to any director, secretary or other principal officer or by leaving it at the office of the corporation or company. The combined effect of Section 78 of the 1990 Act and Order 12 Rule 8 of the High Court of Kaduna State (Civil Procedure) Rules, 1987 is that service of a Court process, in contradiction to service of any other document, can be effected by leaving it at the office of the corporation or company. The wordings of Section 78 of the 1990 Act and Order 12 Rule 8 reproduced above are clear and unambiguous” in this context, in my view, means any office of the corporation or company which need not be restricted to the registered office. To hold otherwise is to introduce words outside the unambiguous provisions of the enacted statutory provisions. The intendment of Section 78 of the 1990 Act, I think, is to ameliorate service of Court processes on companies or corporations which hitherto had been cumbersome under the demised 1968 Act, wherein all services of documents, Court or otherwise, on those bodies can only be validly affected by delivery or serving same at the Registered Office of the company or corporation”.

It follows therefore that neither the rule in **WATKINS V. SCOTTISH IMPERIAL INSURANCE CO.**, nor the decision of the Supreme Court in **MARK V. EKE** should apply to service of Court process of the Federal High Court, nor as we shall show presently, to service of any process issued from any of the various High Courts in Nigeria, after the 4th of March, 1990.

High Court Of The Federal Capital Territory (Civil Procedural) Rules 2004

Order 11 Rule 8 Abuja Rules provides:

“When a suit is against a corporate body authorized to sue and be sued in its name, or in the name of an

officer or trustee, the document may be served, subject to the enactment establishing that corporation or company or under which it is registered as the case may be, by giving the writ or document to any director, secretary, or other principal officer, or by leaving it at the corporate office."

This Rule provision is unfortunately not free from ambiguity. Who really is a principal officer of a Company? Is a Manager of a branch of the Company a Principal Officer of the Company? If not, why not? It had been held that the Branch Manager of the Nigerian Airways Limited is a Principal Officer of the Company. It had also been held that the Jos Branch Manager of Savannah Bank of Nigeria PLC was a Principal Officer of the Bank. In **INTIGERATED BUILDERS V. DOMZAQ VENTURES (NIG) LTD**, it was held that a Senior Officer of a Company does not fall into the category of Principal Officer. In **CROSS RIVER BASIN & RURAL DEVELOPMENT AUTHORITY V. ALI SULE**, it was held that a Principal Officer of a Company means and includes one who can pass as an alter ego of the Company. It was further held that a Senior Clerical Officer cum Time Keeper cannot come under the category of Principal Officer of a Company.

It is suggested that much of the burden of Judicial interpretation involved could have been overcome by avoiding the word "**Principal**" and deploying the simple word "**Officer**" as defined under section 367 of CAMA, which includes a director, manager or secretary. The baseline is that the decision of the Supreme Court in **MARK V. EKE** based on **WATKINS V. SCOTTISH IMPERIAL INSURANCE CO.**, to the effect that Court Processes cannot be served on a Manager at a branch of a Company, within the Jurisdiction of the Court, cannot be a rule of general application. One must look to the particular Rules of the particular Court for guidance.

Another question that needs to be answered is, what is a corporate office of a Company? Is it the same as the registered office? Is it the same as the

Head Office of the Company? Is it any office of the Company where its business is carried on? **SECTION 35 (2) (B) OF CAMA** provides for the notice of the address of the registered office of a company as one of the incorporation documents to be filed. That same provision also makes it clear that the registered office need not be the Head office. It is suggested that the corporate office of a Company is any office from which the corporate business of the company is carried on, and not necessarily the registered office or the Head office. It has been held that "**Office of the Corporation or Company**", is not limited to the registered office. It would have made things much simpler if the FCT Rules had adopted the simple word "**office**" without encumbering it with the word "**corporate**" which is not used in the CAMA. The baseline again is that the decision of the Supreme Court in **MARK V. EKE** based on **WATKINS V. SCOTTISH IMPERIAL INSURANCE CO.**, to the effect that Court Process, must be served at the registered office of a Company is not applicable in the High Court of the Federal Capital Territory, Abuja.

High Court Of Lagos State (Civil Procedure) Rules, 2004

The High Court of Lagos State (Civil Procedure) Rules, 2004 is truly exemplary, in that it addressed fully the mischief in Section 36 of the Companies Ordinance, 1968 which Section 78 of CAMA set out to remedy. It provides as follows:

"Subject to any statutory provision regulating service on a registered company, corporate or body corporate, every originating process or other process requiring personal service may be served on the organization by delivery to a director, secretary, trustee or other senior, principal or responsible officer of the organization, or by leaving it at the registered, principal or advertised office or place of business of the organization within the Jurisdiction".

This provision of the Lagos Rules had therefore taken the full opportunity offered by Section 78 of CAMA to make provision for service of Court processes on

Companies within the jurisdiction of the process issuing Court, without the needless problem of discovering or locating the registered office or the head office or the corporate office of the company. Once the company has an advertised office within the jurisdiction or place of business within jurisdiction, Court processes may be served on the company by leaving it at the said advertised office or place of business within the jurisdiction of the Court. The Rules also overcame the problem of determining who a Principal Officer is for the purpose of serving Court processes. Processes may, under the Rule, be served on the Company by delivery to a Director or a Secretary or a Trustee **or other Senior, Principal or responsible officer of the Company.**

The decision in **MARK V. EKE** was delivered by the Supreme Court on Friday, January 23, 2004. The High Court of Lagos State (Civil Procedure) Rules, 2004 came into force on March 4, 2004. It follows therefore that the decision of the Supreme Court in **MARK V. EKE** in any event ceased to be good law in Lagos State with effect from March 4, 2004.

The baseline is however that **MARK V. EKE** was decided per incuriam to the extent that it seemed to establish that under Section 78 of CAMA, Court processes ought to be served on a company mandatorily, by delivery at the registered office of the company. The antiquated decision in **WATKINS V. SCOTTISH IMPERIAL INSURANCE CO.** can therefore not be dug up from its grave and made to apply to processes served out of the registry of the High Court of Lagos State after March 4, 2004. The effect is that it is no longer good law to say that processes issued out of the Registry of the High Court of Lagos State may not be served on a Company at its branch office within jurisdiction whereat it maintains an advertised presence or carries on business.

Imo State High Court (Civil Procedure) Rules, 1988

This was the extant Rules applicable in the High Court of Imo State, Aba Judicial Division when Mark

v. Eke was commenced in 1993. Order 12 Rule 8 of these Rules provides as follows:

“When the suit is against a corporation or a company authorized to sue and be sued in its name or in the name of an officer or trustee, the writ or other document may be served, subject to the enactment establishing such corporation or company or under which it is registered, as the case may be, by giving the same to any director, secretary, or other principal officer, or by leaving it at the office of the corporation or company”.

Applying the decision of the Court of Appeal in **BELLO V. NBN**, it follows that service of the originating process issued in **MARK V. EKE** from the Registry of the High Court of Imo State, Aba Judicial Division in 1993 may be served on the second Defendant in that suit at any of its office or offices within the jurisdiction, and not as the Supreme Court implied at the registered office.

Conclusion

Section 78 of CAMA does not, on the face of it, contain any stipulation that Court processes for service on a Company must be served at the registered office of the Company. To read such a requirement into that Section of the CAMA is to introduce into the provision an extraneous matter. To the extent therefore that the Supreme Court in **MARK V. EKE (2004) 5 NWLR (PT. 865) 54**, followed the case of **WATKINS V. SCOTTISH IMPERIAL INSURANCE CO. [1889] 23 QBD 285** and held in effect that a Court process must be served on a company at its registered office, that decision of the Supreme Court is inconsistent with Section 78 of CAMA and must be considered per incuriam.

If Counsel do not cite a provision or the Court overlooks a provision or reads into the provision what the provision does not say, that oversight makes the decision per incuriam and should not preclude the Court or other Courts, whether of concurrent or

subordinate jurisdiction from reconsidering the matter when next attention is drawn to the oversight. The omission or oversight in this case does not delete Section 78 of the CAMA or cloak it with a meaning alien to it.

The essence of Section 78 of the CAMA was to cure the mischief inherent in Section 36 of the Companies Act of 1968 by allowing each Court to regulate the service of its own processes. The High Court of the various States as well as the Federal High Court and the High Court of the Federal Capital Territory, Abuja had taken full advantage of Section 78 of CAMA to make convenient provision in this regard. The High Court Rules of Enugu State makes a unique and pragmatic provision in its Order 7 Rule 7 which is worth reproducing and we do so hereunder:

*“Service on a limited liability company shall be effected as prescribed in the Companies and Allied matters Act; **Provided** that in default of such provision, service may be effected on the company by registered post addressed to its principal office in the State or by delivery to the principal officer wherever he may be found in the State or by delivery at the company's office in the State, to any one apparently in charge of such office. **Provided** further that where the company has no office in the state, service shall be effected by registered post”.*

Apart from the specific Rules discussed in detail above, the Rules of the various States made Rules mutatis mutandis.

The current trend whereby subordinate Courts treat the Supreme Court's pronouncement in Mark V. Eke as the defining law on service of process on Companies is most unfortunate. This is more so when all the Rules of Court now in force in the various jurisdictions of the High Court were made after the decision in Mark V. Eke.

It is hoped that the Courts would become more attentive to the Rules contained in there Rules

rather than being fixated to the decision in Mark V. Eke which is neither in line with Section 78 of CAMA nor in line with the extant Rules of the Courts.

THE BRIEF

**AWARD OF PREJUDGMENT INTEREST:
A.G. FERRERO V HENKEL CHEMICALS;
CASE REVIEW**

Claims relating to interests constantly feature in suits filed before courts in Nigeria and over the years have been the subject of several appeals. While Nigerian courts have established precedents with regard to post judgment interests owing mostly to the various rules of courts permitting such awards subject to court discretions¹, the practice relating to award of prejudgment interests remains uncertain. Save for a few isolated cases, Nigerian courts² have relied mostly on the common law holding in *London Chatham & Dover Railway v. S.E. Railway Co*³. to hold that interest may only be claimed as of right where it is contemplated by agreement between parties, under mercantile custom, statute, or under a principle of equity such as breach of fiduciary relationship⁴. Taking a cue from the position of the courts in this regard, most legal practitioners in Nigeria often strive to ensure that claims relating to interests are amply covered in client

¹See for instance the Supreme Court decision in *Ekunife v. Wayne (West Africa) Ltd (1989) 5 NWLR (Pt.122) 422*.

²*Nigeria General Superintendence Co. Ltd v. The Nigerian Ports Authority (1990) 1 NWLR (Pt. 129) 741 and Adeyemi v. Lan & Baker (Nig) Ltd (2000) 7 NWLR (Pt.663) 33*.

³[1893] AC 429.

⁴See *Ekunife v Wayne (West Africa) Ltd*, *ibid* and *Diamond Bank Ltd v. Partnership Investment Co. Ltd and Anor (2009) LPELR-SC.26/2002*.



contracts, so as to avoid losses from late payment of monies stipulated in contracts.

Such practice must have been so predominant, as it was only recently that the Nigerian Supreme Court got the opportunity to rule on a case where the parties had neglected to include a clause on interest in their construction contract. In *A.G. Ferrero & Co. Ltd v. Henkel Chemical (Nigeria) Ltd*,⁵ the Supreme Court was faced with the challenge of deciding whether a party was entitled to an award of prejudgment interest on money paid later than the due date even when such interest was not specifically made a part of the agreement of the parties. Unanimously upholding the principle enunciated in the *London Chatham & Dower Railway* case, the Supreme Court held that such award of interest was impossible unless stipulated under the agreement of parties, supported by mercantile custom, statute or claimed under a principle of equity such as breach of fiduciary relationship.

This newsletter analyzes the decision of the Supreme Court in *A.G. Ferrero* alongside previous decisions of both the Supreme Court and other courts in Nigeria on award of prejudgment interests. It argues that the court's reasoning in that case is mostly unsupportable and that Nigerian courts ought to move away from certain common law rules which do no more than inflict economic hardship on parties operating in the 21st century world. The newsletter refers to a recent English case, *Sempra Metals Ltd v. HM Commissioners of Inland Revenue*⁶ and argues that the justice

served by the House of Lords in that case works well for modern day transactions than what is presently obtainable in Nigeria.

A.G. Ferrero v. Henkel Chemicals: Background Facts

The parties before the Supreme Court entered into a construction contract in 1987 for A.G. Ferrero, the Appellant, to construct a soap and detergent factory and, an office building at Kudenda Industrial Layout in Kaduna for the Respondent, Henkel Chemicals. The agreement was for the sum of N3,854,938.10 payable in parts on receipt of certificates of payment issued by architects appointed by the Respondent. The agreement specified payment within 21 days of receipt of each certificate, which payments the Respondent continued to make until 1989 when it refused to pay on Architect Certificate No. 18 dated 17/12/1989 for N449,474.45 despite Appellant's demands. A.G. Ferrero subsequently sought judgment in the sum owed on Architect Certificate No. 18 with interest at the minimum rate of 25% per annum from the date of default, 29/12/1989 till judgment and thereafter interest on the judgment debt at the rate of 10% per annum from date of judgment until satisfaction.

After hearing the case on the merits, the trial court found that the non-payment of the debt due from 29/12/1989 to the date of judgment, 16/06/2000 (more than ten years after it became due), resulted in loss of savings and profits in favour of A.G. Ferrero. Consequently, the trial court granted the reliefs sought including, the prejudgment interest. On appeal, the Court of Appeal reversed the prejudgment interest awarded by the trial court. The Court of Appeal concluded in part that there was no material

⁵(2011) All FWLR (Pt 587) P. 647

⁶[2007] UKHL 34.

before the trial court from which the court could have inferred that compensatory award of interest on claims outstanding beyond 21 days of receipt of Architect Certificate was within the contemplation of parties. In addition, the Court of Appeal held that a party cannot unilaterally impose a term of contract on the other and that the right of interest is not established without reference to a fiduciary relation, trade practice, or custom or mercantile usage or statute providing for such interest.

In upholding the decision of the Court of Appeal, the Supreme Court relied solely on the terms of contract and held that in the absence of any specific provision for payment of interest in the contract agreement, the award of prejudgment interest by the trial court was wrong. The court distinguished the decisions in *Nigerian General Superintendence Co. Ltd v. Nigeria Ports Authority*⁷ and *Adeyemi v. Lan & Baker (Nigeria) Ltd*⁸, and held that the two cases “were decided on the principle that in purely commercial transactions, a party who holds on to money of another for a long time without any justification and thus deprives that other of the use of such funds for a period should be liable for compensation by way of interests.” The Supreme Court further stated that:

“The principle in the two cases [*Nigerian General Superintendence Co. Ltd v. Nigeria Ports Authority* and *Adeyemi v. Lan & Baker (Nigeria) Ltd*] pertains to normal commercial transactions without reference to any particular agreement, oral or documentary, in contradistinction to the present case [*A.G. Ferrero v.*

Henkel Chemicals] wherein the parties agreed to and are bound by a written contractual agreement.”

Justice Rhodes-Vivour wholly agreed with Justice Tabai's decision as above. Citing the *London Chatham & Dower Railway* case, Justice Rhodes-Vivour stated that “before an interest can be recoverable as an ordinary debt at common law, there must be in place, (a) contract express or implied; or (b) some mercantile usage; (c) statute such as the [J]udgment Act of 1838 and Sections 9 and 57 of the Bill of Exchange Act Cap 35 of the Laws of the Federation of Nigeria, 1990.”

Case Analysis on Award of Prejudgment Interest in Nigeria

In order to fully appreciate the holding in the *A.G. Ferrero* case, it is important to analyze the case alongside some of those distinguished by the Supreme Court. One of such, *Adeyemi v. Lan & Baker (Nigeria) Ltd*⁹, which came before the Court of Appeal sitting in Lagos in 2000 involved a claim for principal and compound interest for sums advanced for purchase of rice which was never supplied. Delivering his judgment in that case, Aderemi J.C.A. held as follows:

“On the issue of award of interest on the sum claimed at the rate of 14% per annum from 1st September, 1984 till 20th March, 1986 a prejudgment interest I cannot find any fault with the pronouncement of the court below on it. The principle admits of no argument indeed, it is very equitable

⁷ibid.

⁸ibid.

⁹ibid.

that where money is owing from one party to another and that other is driven to have a recourse to legal proceedings in order to recover the amount due from him the party who is wrongfully holding on to the money from the other ought not, in justice, be allowed to benefit by having that money in his exclusive possession and enjoying the use of same when that money, as in the instant case, ought to be in the possession of the other party (here the plaintiff/respondent) who is entitled to its use, having not been supplied with rice for which it put down the money. That award of interest is equitable compensation¹⁰."

As noted earlier, the Supreme Court in *A.G. Ferrero* distinguished the holding in *Adeyemi*, arguing that the principle in that case only applies to "purely commercial transactions". Justice Tabai stated that:

"... there is no doubt that *Nigerian General Superintendence Co. Ltd v. Nigeria Ports Authority* (*supra*) and *Adeyemi v. Lan & Baker (Nigeria) Ltd* (*supra*) cited by the Appellant were decided on the principle that in purely commercial transactions, a party who holds on to money of another for a long time without any justification and thus deprives that other of the use of such funds for the period should be liable to pay compensation by way of interests."

¹⁰ibid at pages 51-52.

The Learned Justice Tabai repeated the assertion in the paragraph subsequent to the quotation above when he suggested that principle established by the *Adeyemi* case above only applies to:

"Normal commercial transactions without reference to any particular agreement, oral or documentary ..."

It is instructive to note that the Supreme Court failed to define what exactly it meant by "*purely commercial transactions*" and "*normal commercial transaction*" or even the criteria it relied on in deciding that a construction contract involving payment of money for work done does not fall within the category of "*purely or normal commercial transactions*." It is submitted that the attitude of the Supreme Court in this regard only serves to heighten uncertainty in this area.

The above paragraph notwithstanding, what is most worrying, however, is the attempt by the Supreme Court to distinguish between existing agreement situations and situations where no agreement exists, "oral or documentary," as the basis for refusing to uphold the trial court's award of prejudgment interest. Is the Supreme Court saying in effect that equity will refuse to aid a party who suffers loss from failure of another party to pay its debts after receiving benefits from a contract merely because the parties failed to agree on interest at the time of contract? Assuming a party successfully pleads and proves specific losses incurred as a result of failure to pay debt for any number of years, days or even months, is the Supreme Court saying that it will refuse to compensate the party for such losses for the singular reason that the

parties failed to include specific provisions in contract?

It is submitted that rather than make such pronouncements as above, the Supreme Court ought to have considered among others whether the party adduced sufficient evidence to prove actual losses as the Court of Appeal did in part. While some may argue that the decision of the Supreme Court in *A.G. Ferrero* is in consonance with its earlier decision in *Ekwunife v Wayne*, where it held, per Nnaemeka-Agu, J.S.C that:

“Where interest is being claimed as a matter of right, the proper practice is to, claim entitlement to it on the writ and plead facts which show such an entitlement in the statement of claim ... Adjudication on the plaintiff’s right to interest in such a case is, like any other issue in the case, based on evidence placed before the court. The evidence called at trial in such a case will also establish the proper rate of interest and the date from which it should begin to run whether from accrual of the cause of action or otherwise.”

It is respectfully submitted, however, that the “evidence” suggested in *Ekwunife* need not only be by way of an interest clause in an agreement granting a party the right to claim interest in the event of payment default, but should also include facts alleging actual losses suffered by a party even when a claim of interest is not covered by the agreement. Such evidence could cover facts alleging interests accruing on

sums borrowed to complete work agreed on the contract or money expended to purchase materials pursuant to obligations under the contract. So long as the claimant is able to satisfy the usual remoteness tests, which could include evidence that such losses were reasonably foreseeable at the time of contract as likely to result from breach, the court should not refuse a remedy solely on the absence of an agreement on interest.

The Supreme Court should have used the opportunity presented by *A.G. Ferrero* to clarify this issue.

UK Approach

It is instructive to note that courts in other jurisdictions are moving away from some common law practices that are perceived as occasioning injustice in present day transactions. The House of Lords recently considered the continued application of the rule relating to entitlement to interest in contractual, tortious and restitutionary claims in the *Sempra Metals* case cited above.

The case concerned claims by a UK resident company with a parent company in Germany, *Sempra Metals Ltd*, for interest on advance corporate tax payments on dividends which the UK authorities demanded in breach of certain provisions of the European Community Law. The payments were subsequently set off against *Sempra Metals'* mainstream corporate tax, but the intervals between the advance corporate tax payment and the time of set off varied considerably. The court found that the shortest interval was just under one year and the longest almost ten years. Thus, *Sempra Metals* was no

longer claiming the payments made, but brought an action claiming compound interest on the amount for the periods between the unlawful payment and eventual application of the funds to set off its mainstream corporate tax.

The decision by the court of first instance that the compensation due to Sempra should be calculated on a compound basis was subsequently upheld by the Court of Appeal which made it clear that interest should be computed by compounding at the same periodic rests as those by reference to which the applicable rate of interest is fixed. On appeal before the House of Lords, an interesting discussion arose among the Law Lords consisting of Lords Hope, Nicholls and Walker in the majority and Lords Scott and Mance in the minority on certain aspects.

For purposes of clarity, it is important to set out as much as space would allow in this paper, the extensive lead judgment of the House of Lords on the issue. Delivering the lead judgment, Lord Nicholls made the following observations in relation to interest losses and damages:

"I start with the broad proposition of English law that as a general rule a claimant can recover damages for losses caused by a breach of contract, or a tort which satisfy the usual remoteness tests. This broad common law principle is subject to an anomalous, that is, unprincipled, exception regarding one type of loss arising in respect of one particular type of claim. The

exception comprises claims for interest losses by way of damages for breach of a contract to pay a debt. The general common law principle does not apply to such claims. Damages are not recoverable in cases falling within this exception¹¹."

Consequently, Lord Nicholls went into a very long exposition of the origin of the exception to the general principle which he described as unimpressive. He quoted a comment by the late Dr F A Mann on "Interest, Compound Interest and Damages" (1985) 101 L Q R 30, page 47 where the latter said that the exception showed the common law of England 'at its worst'¹².

Lord Nicholls continued:

"I can start in 1829. That is when matters took an unfortunate turn. In that year Lord Tenterden CJ delivered the judgment of the Court of the King's Bench in *Page v Newman* (1829) 9 B&C 378. Captain Page had loaned various sums of money to Mr Newman while they were prisoners of war in Verdun in 1814. In 1819 Mr Page claimed repayment of £135 plus interest. The court held that, in the absence of agreement, money lent does not carry interest. The reasoning was one of practical convenience. The contrary rule would be 'productive of great inconvenience', because 'it

¹¹ibid at 74.

might frequently be made a question at nisi prius whether proper means had been used to obtain payment of the debt, and such as the party ought to have used' (page 381). In other words, difficulties might arise in determining whether a claimant had taken appropriate steps to mitigate his loss.¹³

Proceeding Lord Nicholls stated that:

"In 1893 the problem came before your Lordships' House in *London Chatham & Dover Railway v. S.E. Railway Co* [1893] AC 429. The appellant company claimed money due on taking account together with interest. The official referee who took the money allowed interest under Lord Tenterden's Act. On appeal the company contended that, even if it was not within the statute, it could still recover interest by way of damages for wrongful detention of its debt. The House rejected the submission. The House decided that at common law a court had no power to award interest by way of damages for late payment of a debt¹⁴.

The House reached its conclusion with reluctance. Lord Herschell LC said that a person wrongfully withholding money ought not in

justice to benefit by enjoying the use of that money (page 437)¹⁵."

Continuing Lord Nicholls stated:

"I go further, in view of wide-ranging arguments presented to your Lordships. The common law should sanction injustice no longer. The House should recogni[z]e the remnant of the restrictive common law exception for what it is: the unprincipled remnant of an unprincipled rule. The House should erase the remains of this blot on English common law jurisprudence¹⁶".

In conclusion, Lord Nicholls stated:

"To this end, if your Lordships agree, the House should now hold that in principle, it is always open to a claimant to plead and prove his actual interest losses caused by late payment of debt. These losses will be recoverable, subject to the principles governing all claims for damages for breach of contract, such as remoteness, failure to mitigate and so forth¹⁷.

In the nature of things the proof required to establish a claimed interest loss will depend on the loss and circumstances of the case. The loss may be the cost of borrowing

¹²ibid at 75.

¹³ibid at 76.

¹⁴ibid at 78.

¹⁵ibid at 79.

¹⁶ibid at 92.

¹⁷ibid at 94.

money. That cost may include an element of compound interest. Or the loss may be loss of an opportunity to invest the promised money. Here again, where the circumstances require, the investment loss may need to include a compound element if it is to be a fair measure of what the plaintiff lost by the late payment. Or the loss flowing from the late payment may take some other form. Whatever form the loss takes the court will, here as elsewhere, draw from the proved or admitted facts such inference as are appropriate. That is a matter for the trial judge. There are no special rules for proof of facts in this area of law¹⁸."

But an unparticulari[z]ed and unproved claim for 'damages' will not suffice. General damages are not recoverable. The common law does not assume that delay in payment of a debt will of itself cause damage. Loss must be proved. To that extent the decision in the *London Chatham & Dover Railway* case remains extant. The decision in that case survives but is confined narrowly to claims of a similar nature to the simple claim for interest advanced in that case¹⁹."

With respect, it would appear that the ruling of the court in the *Sempra Metals* case seem more in tune with present-day challenges than what is currently available in Nigeria. The overall holding in *Sempra Metals* seem slightly similar to the reasoning of Aderemi J.C.A in the Nigerian case of *Adeyemi v Lan & Baker* which the Supreme Court distinguished except that the Learned Justice of the Court of Appeal in that case based his decision in equity. The Supreme Court ought to seize opportunities appearing before it to add to existing interpretations and not take from them.

Justification for Common Law

Lord Nicholls in the *Sempra Metals* case discussed above likened the common law rule relating to award of compound interest on claims for debt paid late to an "unsound rule which like the proverbial bad pennies turn up again and again²⁰." He was quick to caution that for the law to achieve a fair and just outcome when assessing financial loss, it must recognize and give effect to the reality of everyday life in the 21st century where interest payments for the use of money are calculated on a compound interest basis with no money available commercially on simple interest terms.

Now the question to ask is this: if the courts in the country where the rules of common law were originally "formulated" are calling on judges to "consider how far the common law should still abide in a world where present-day economic reality is not allowed to intrude²¹," and are radically moving away from rules they consider unsupportable, why are the courts in the country

¹⁸ibid at 95.

¹⁹ibid at 96.

²⁰ibid at 51.

²¹See Lord Nicholls in *Sempra Metals* case, ibid at 55.

where the rules of common law were merely “received”²²,” who played no part whatsoever in the formulation, so fixated on abiding by the rules even in the face of obvious injustice? Shouldn't courts in Nigeria be quick to throw the rules out of the door when its application will do no more than take the country back to the early 19th century England?

It is true that A.G. Ferrero's case may still have failed for failure of the party to plead and prove actual losses caused by Henkel's failure to pay its debts²³. Nevertheless, to expressly preclude award of prejudgment interest owing to parties' failure to include “specific provisions for the payment of interest in their contractual agreement”²⁴ seems mostly unfair. This is especially so when a party inexcusably deprives another use of monies owed for accumulated periods of time, such as the 10-year period in the *A.G. Ferrero* case. In this regard, Lord Nicholls' comments in *Sempra Metals* case are instructive. In that case, Lord Nicholls stated a previous rule of the House of Lords in *President of India v. La Pintada Compania Navigacion SA* [1985] 1 AC 104 that:

“... contrary to the general understanding of the effect of the *London Chatham and Dover Railway* case, claims for damages for interest losses suffered as a

result of the late payment of money are not a taboo. That is plainly right. Those who default on a contractual obligation to pay money are not possessed of some special immunity in respect of losses caused thereby.”²⁵

Nevertheless, the court in that case stated that:

“To be recoverable losses suffered by a claimant must satisfy the usual remoteness tests. The losses must have been reasonably foreseeable at the time of contract as liable to result from the breach. But, subject to satisfying the usual damages criteria, in principle these losses are recoverable as damages for breach of contract. This is even so if the losses consist of a liability to pay borrowing costs incurred as a result of late payment, as happened in *Wadsworth v. Lydall* [1981] 1 WLR 598. And this is irrespective of whether the borrowing cost comprise simple or compound interest”²⁶.

Conclusion

It is necessary to point out that judicial activism may ultimately hold the key for Nigeria to successfully move away from obsolete practices

²²Received as part of the laws that were in force in England on the 1st day of January, 1900; see Nnaemeka-Agu J.S.C. in *Ekwunife v Wayne*.

²³The Court of Appeal suggested this much in part when it held that “there was no material

before the court [trial court] to infer that compensatory award of interest on the claim outstanding beyond 21 days of receipt of valuation of certificates was within the contemplation of the parties.”

²⁴See Justice Tabai in *A.G. Ferrero v. Henkel Chemicals*, *ibid*.

²⁵*ibid* at 93.

²⁶*ibid*

which occasion grave injustice within the system. Courts in Nigeria should strive to give appropriate interpretations to remedy injustices created by the rules of common law along with others occasioned by the application of some of the obsolete legislation the Nigerian legislature has shown no interest in reviewing

Should the opportunity arise again in the nearest future, it is hoped that the Supreme Court would toe the path of justice over unsavory rules and practices.

SEPARABILITY OF ARBITRATION CLAUSES: NNPC v. CLIFCO REVISITED

Introduction

The Supreme Court of Nigeria recently rejected an opportunity to exhaustively determine the application of the “separability doctrine” in novation of contract arrangements, which thus far remains an unsettled area of law in Nigeria as well as in many other jurisdictions. That opportunity came in the 2011 case of Nigerian National Petroleum Corporation v. CLIFCO Nigeria Limited.¹

The case involved a challenge of the jurisdiction of an arbitral tribunal to render an award on the basis of an arbitration clause contained in a contract between parties which had been substituted by a new agreement having no arbitration clause. The Supreme Court unanimously dismissed the appeal on the basis that the Appellant, the Nigerian National Petroleum Corporation (NNPC), failed to raise the jurisdictional objection before the arbitral tribunal in compliance with the provisions of the Arbitration and Conciliation Act of 1990 (ACA).² However, while majority of the learned justices based the reasoning on jurisdiction alone,³ Justice J.A. Fabiyi opted to extend his

¹ (2011) LPELR-SC.233/2003

² Cap A18, LFN 2004; Article 12.

³ Delivering the lead judgment, Justice Bode Rhode-Vivour refused to consider questions on whether the arbitration clause in that case is separate from contract, and survived an earlier agreement of parties, and whether there was novation or the effect of it, preferring instead to see such questions as no longer moot.



reasoning to the effect of novation on arbitration clauses contained in abrogated contracts. In the words of the Learned Justice, "... where there is novation, purpose of contract may fail but the arbitration clause survives. See *Heyman v. Darwin[s] Ltd.* (1942) AC 356 at 373."⁴

This newsletter examines the full import of the Supreme Court judgment as encapsulated in the two paragraph analysis of the separability of an arbitration clause from the underlying contract of parties and the effect (or lack of it) of novation on arbitration clauses contained in abrogated agreements of parties. It argues that by failing to undertake a full analysis of the issue, the Supreme Court missed out on the opportunity to clarify this area of law that has been subject to conflicting decisions of courts in several jurisdictions including the UK.

NNPC v. CLIFCO: Background Facts

The case arose from a 1994 agreement between NNPC and CLIFCO in which NNPC agreed to sell twenty-four cargoes of Vacuum Gas Oil (VGO) to CLIFCO at the rate of one cargo per month for a period of two years. The parties inserted an arbitration clause in that agreement, wherein they agreed to settle disputes by arbitration. By the end of the two-year contract period, NNPC had only sold five out of the agreed twenty-four cargoes of VGO to CLIFCO. Rather than institute an action for breach, CLIFCO entered into a novation agreement with NNPC in 1999 to substitute the old agreement with the new. Essentially, the parties agreed that NNPC will supply nineteen cargoes of Low Pour Fuel Oil (LPFO) under the new agreement at the same rate as the initial contract agreement, but failed to include an arbitration clause in the new agreement. NNPC again failed to perform under the new agreement and CLIFCO proceeded to arbitration. In December 2000, the arbitral tribunal made an

award in favour of CLIFCO. NNPC thereafter instituted an action before the Federal High Court to set aside the award made by the tribunal.

On appeal before the Supreme Court, NNPC argued that the Court of Appeal erred in law when it held that the arbitral tribunal had jurisdiction to entertain the claim notwithstanding the novation which had the effect of extinguishing the agreed terms, including the arbitration clause, under the initial contract. Rejecting the argument, the Supreme Court unanimously held that by failing to raise the issue of jurisdiction before the arbitral tribunal in compliance with Article 12(3)(a) of ACA, NNPC forfeited its right to challenge the jurisdiction of the tribunal and cannot be allowed to raise the issue for the first time in the High Court.⁵ *NNPC v. CLIFCO*, *ibid.* Article 12(3)(a) of ACA requires a party involved in arbitration to challenge the jurisdiction of the tribunal no later than the time of submission of the points of defence. Nevertheless, the tribunal may admit a later plea where it satisfied that the delay is justified. See Article 12(3)(b).

In addition, the Supreme Court per Justice J.A. Fabiyi held that an arbitration clause in an agreement is generally regarded as separate from the main agreement, so that where there is novation, the arbitration clause will survive even when the purpose of the contract fails.

Scope of Arbitration

In arriving at the decision above, Justice Fabiyi relied on the English case of *Heyman v. Darwins Ltd.*⁶ The Learned Justice laid down the requisites for novation as including, "a previous valid obligation, an agreement of all the parties to a new contract, the extinguishment of the old obligation and the validity of a new one."⁷ He then argued that going by the decision in *Heyman*, "where there is novation,

⁴ *NNPC v. CLIFCO Nig. Ltd.* *ibid.*

⁶ [1942] A.C. 356.

⁷ *NNPC v. CLIFCO*, *ibid.*

purpose of contract may fail but the arbitration clause survives.”⁸

Respectfully, it would seem that the learned justice did not critically analyze the decision of the court in *Heyman*. The House of Lords made a very interesting analysis of the scope of arbitration in that case beyond what the Learned Justice Fabiyi stated. The case which involved a repudiation of contract by one party and acceptance by the other was brought before the court with the aggrieved party claiming damages under a number of heads. The House of Lords acknowledged that the language of the arbitration clause in that instance was all encompassing as “it embraces any dispute between the parties “in respect of” the agreement, or in respect of any provision in the agreement, or anything arising out of it.” It held that the dispute was one within the arbitration.⁹

Nevertheless, a wider discussion of the relevant principle ensued in the speeches delivered by the Law Lords. Viscount Simon L.C. observed that:

“An arbitration clause is a written submission, agreed to by the parties to the contract, and, like all other written submissions to arbitration, must be construed according to its language. If the dispute is whether the contract which contains the clause has ever been entered into at all, that issue cannot go to arbitration under the clause, for a party who denies that he has ever entered into a contract is thereby denying that he ever joined in the submission. Similarly, if one party to the alleged contract is contending that it is void ab initio (because, for example, the making of such a contract is illegal), the arbitration clause

cannot operate, for on this view the clause itself also is void.”¹⁰

Lord Macmillan also observed that “arbitration clauses in contracts vary widely in their language for there is no limitation on the liberty of contracting parties to define as they please the matters to submit to arbitration.”¹¹ He continued by saying that:

“If it appears that the dispute is whether there has ever been a binding contract between the parties, such a dispute cannot be covered by an arbitration clause in the challenged contract. If there has never been a contract at all, there has never been as part of it an agreement to arbitrate. The greater includes the less. Further a claim to set aside a contract on such grounds as fraud, duress or essential error cannot be the subject matter of a reference under an arbitration clause in the contract sought to be set aside. Again, an admittedly binding contract containing a general arbitration clause may stipulate that in certain events the contract shall come to an end. If the question arises whether the contract has for such reason come to an end I can see no reason why the arbitrator should not decide that question. It is clear, too, that the parties to a contract may agree to bring it to an end to all intents and purposes and to treat it as if it had never existed. In such a case, if there be an arbitration clause in the contract, it perishes with the contract. If the parties substitute a new contract for the contract which they have abrogated the arbitration clause in the abrogated contract cannot be invoked for the determination of questions under the new agreement. All this is more or less elementary.”¹²

⁸ *ibid.*,
⁹ *ibid.*, 360.

¹⁰ *ibid.*, 366.

¹¹ *ibid.*, 370.

¹² *ibid.*, 371.

These positions have since been modified in subsequent cases as we shall see below. It is however noteworthy to state that the latter part of Lord Macmillan's observations above contradict with Justice Fabiyi's position in *NNPC v CLIFCO*.

The reasoning of the Law Lords in *Heyman's* case was adopted by the Indian Supreme Court in *Union of India v. Kishorilal Gupta and Bros.*¹³ In that case, the parties entered into earlier contract arrangements for the supply of raw materials with agreements to settle disputes arising by arbitration. The contracts were subsequently cancelled and the parties amicably settled the dispute which settlements were captured in new agreements. Broadly speaking, the contractor agreed to pay certain sums to the Union of India under the new agreements but failed to satisfy the obligations. Union of

India revived the earlier contract and filed a claim in arbitration. Relying on the principles laid down in *Heyman*, the Indian Supreme Court held that the earlier contract cannot be revived. The court affirmed an earlier High Court decision on the matter and held that after the execution of the third settlement contract, earlier contracts and arbitration clause extinguished.

The principles established in *Heyman* as described above would have aided a conclusion that the Supreme Court of Nigeria was wrong in dismissing *NNPC's* claim, but for a combination of factors. First of which is the fact that *NNPC's* failure to challenge the jurisdiction of the arbitral tribunal as required by the *ACA* adversely affected its subsequent suit before the court. The second factor is the separability doctrine, established in Nigeria through Article 12(2) of *ACA*. Majority of the cases decided since the doctrine was made popular by the *UNCITRAL* Model Law on International Commercial

Arbitration 1985 (Model Law) have found that an arbitration clause is a separate agreement, ancillary to contract, and unless the clause itself is directly impeached, is capable of surviving the invalidity of the contract supporting it.¹⁴

Requirements of a valid arbitration – Jurisdiction of the Arbitrator

Arbitration agreements are by law required to be in writing.¹⁵ Article 7(3) of the Model Law explains that an arbitration agreement is in writing if it is recorded in any form, whether or not the arbitration agreement or contract has been concluded orally, by conduct, or by other means. Similarly, the Supreme Court of Nigeria in the *Owners of the MV Lupex v Nigerian Overseas Chartering & Shipping Ltd*¹⁶ defines an arbitration clause as "a written submission agreed by the parties to the contract, and like other written submissions must be construed according to its language and in the light of the circumstances in which it is made".

Emilia Onyema argues that the consent to submit any eventuating dispute to arbitration is fundamental in consensual arbitration references and so must be evidenced clearly.¹⁷ She cautions that the importance of this evidence cannot be over-emphasized since opting to arbitrate a particular dispute operates as an ouster of the jurisdiction of the competent court over that particular dispute between the particular parties.¹⁸ Continuing, *Emilia Onyema* submits that section 36 of the Constitution of the Federal Republic

¹⁴ See *Habour v Kansa* [1992] 1 Lloyds Rep 81.

¹⁵ Article 1(1) of *ACA*; Article II of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (New York Convention) – Nigeria is a party to this Convention; and Article 7(2) of the Model Law.

¹⁶ (2003)15 NWLR (pt 844) 469

¹⁷ See *Onyema, Emilia, The Doctrine of Separability under Nigerian Law* (2009) SOAS School of Law Research Paper No. 03-2010 *Apogee Journal of Business, Property & Constitutional Law*, Vol. 1, No.1 2009. Available at SSRN: <http://ssrn.com/abstract=1621383>. Last accessed 30/05/2012.

¹⁸ *ibid.*

¹³ AIR 1959 SC 1362.

of Nigeria 1999 guarantees individuals' right of access to Nigerian courts for the resolution of disputes.¹⁹ Therefore, she argues that to waive such right, there must be clear unequivocal evidence of such waiver, which evidence is best proved through a written agreement clearly evidencing consent of the parties to opt out of legislation before a national court and submit to arbitration.²⁰ Consequently, a valid and enforceable arbitration agreement must exist for an arbitrator or tribunal to exercise jurisdiction over parties.²¹

The English Court in *Habour v Kansa*²² per Steyn J observed that the foundation of an arbitrator's authority is the arbitration agreement. The court in that case stated that:

"If the arbitration agreement does not in truth exist; the arbitrator has no authority to decide anything. Similarly, if there is an issue as to whether the arbitration agreement exists, that issue can only be resolved by the court. For example if the issue is as to whether a party ever assented to a contract containing an arbitration clause, the issue of lack of consensus impeaches the arbitration agreement itself. Similarly, the arbitration agreement itself can be directly impeached on the ground that the arbitration agreement itself is void for vagueness, void for mistake, avoided on the ground of misrepresentation, duress and so forth. All such disputes fall outside the scope of the arbitration agreement, no matter how widely drawn, and are obviously outside the arbitrator's jurisdiction. The scope of the principle of separability of the arbitration agreement

[as discussed below] only arises for consideration where the challenge is directed at the contract, which contains an arbitration clause."

The first part of the court's observation in *Habour v Kansa* above may seem unsupportable in the Nigerian context in view of Article 12(1) of ACA. Article 12(1) provides that "an arbitral tribunal shall be competent to rule on questions pertaining to its own jurisdiction and on any objections with respect to the existence or validity of an arbitration agreement."²³ While questions relating to validity are clearly covered under Article 12(1), the difficulty here is to ascertain whether the phrase "with respect to the existence of an arbitration agreement" includes situations where a party argues that it did not in fact enter into an arbitration agreement under the new arrangement.

Some may argue that such a challenge in effect means a challenge of the existence of an arbitration clause in the new agreement. If that argument is supported, the party challenging the jurisdiction of the arbitrator would then be required to raise his objection before the arbitral tribunal no later than the time of submission of his points of defence or forfeit his right.²⁴ A contrary argument may be made, however, in view of Emilia Onyema's submissions above, that the parties had no intention to proceed to arbitration under the new contract, hence the failure to include an arbitration clause in the new agreement. Consequently, in the absence of a written agreement clearly evidencing the parties' intention to opt out of adjudication of the domestic courts and to submit to arbitration in the new agreement, a party's constitutionally guaranteed right of access to court ought to be protected. If this argument prevails, a party (such as NNPC in the *NNPC v. CLIFCO* case

¹⁹ *ibid.*

²⁰ *ibid.*

²¹ Onyema, Emilia *ibid.*

²² *Habour v Kansa ibid.*, 85.

²³ The Supreme Court relied on Article 12(3) (a) to dismiss the appeal instituted by NNPC. See also Article 21(1) & (2) of the Arbitration Rules.

²⁴ Article 12(3) (a) of ACA.

above) would not be required to comply with the provisions of Article 12 of ACA and the supporting Article 21 of the Arbitration Rules. Thus, while it may be logical to argue as above, that the dispute between the parties in NNPC v. CLIFCO rightly falls within the category of questions which Article 12(1) of ACA permits an arbitral tribunal to determine, it is still possible to make the argument in the preceding paragraph. Short of an intention to discontinue with the terms of an abrogated contract,²⁵ it is difficult to see how commercial contractors who are almost always adequately represented would omit an arbitration clause from their new agreement if they actually intended it to regulate their relations. If anything, a simple incorporation by reference would have clarified the intention of the parties. This is therefore an area that would benefit immensely from court clarification in Nigeria.

Doctrine of Separability

Separability means that an arbitration clause shall be treated as an agreement independent of the other terms of contract; as a consequence, a decision by an arbitral tribunal that the contract is null and void shall not entail ipso jure the invalidity of the arbitration clause.²⁶ The doctrine only arises if the arbitration agreement forms part of a written contract.²⁷ Emilia Onyema submits in line with this doctrine that the best proof of a party's consent to arbitrate a particular dispute is the production of a written arbitration agreement.²⁸ The separability doctrine is covered under Article 12(2) of ACA, supported by Article 21(2) of the Arbitration Rules. Article 12(2) of ACA provides that:

“For purposes of subsection (1) of this section, an arbitration clause which forms

part of a contract shall be treated as an agreement independent of the other terms of the contract and a decision by the arbitral tribunal that the contract is null and void shall not entail ipso jure the validity of the arbitration clause.”

The draftsman of that portion of the Act appears to have made an omission in the latter part of the Article 12(2) by using the word “validity” instead of “invalidity” which is what appears in the Model Law upon which the ACA was based.²⁹ That mistake appears to have been corrected in the Rules supporting Article 12(2). Article 21(2) of the Arbitration Rules stipulates that:

“For purposes of this article, an arbitration clause which forms part of a contract and which provides for arbitration under these Rules shall be treated as an agreement independent of the other terms of the contract. A decision by the arbitral tribunal that the contract is null and void shall not entail ipso jure the invalidity of the arbitration clause.”

Article 12(1) supports arguments that the separability doctrine is inextricably linked with the doctrine of competence- competence.³⁰ As noted severally above, that article grants an arbitral tribunal “competence to rule on questions pertaining to its own jurisdiction and on any objections with respect to the existence or validity of an arbitration agreement.”³¹ Consequently, Article 12(2) requires an arbitrator or arbitral tribunal to treat an arbitration clause contained in a contract as independent of the contract; so that the arbitrator still retains the jurisdiction to make a determination solely on the basis of an arbitration clause even where

²⁵ Which would include an arbitration clause.

²⁶ See the Explanatory Note 25 to Article 16(1) of the Model Law. See also Article 16 of the Model law.

²⁷ *Habour v. Kansa* *ibid*, 85.

²⁸ *ibid*.

²⁹ See Article 16(1) of the Model Law.

³⁰ See Onyema, Emilia *ibid*.

³¹ See also Article 21(1) of the Arbitration Rules; Article 16(1) of the Model Law.

the underlying contract fails. Emilia Onyemaciting Tweedale and Tweedale notes that the primary effect on any arbitral reference of the doctrine of separability is that the underlying contract containing the arbitration clause may be void but the arbitration agreement may survive.³²

However, notwithstanding that the separability doctrine assures parties of the ability of an arbitration clause to stand alone independent of the contract, an arbitrator is only competent to exercise jurisdiction over a valid arbitration agreement. As previously noted, to be valid an arbitration agreement must comply with the writing requirement under Article 1(1) of ACA.

Applying that argument to the NNPC v. CLIFCO case therefore, it is submitted that unless it becomes clear and unequivocal that the arbitration clause in the abrogated contract survived the novation or that the parties intended to submit to arbitration pursuant to the abrogated agreement, the non-existence of an arbitration clause in the new agreement between the parties renders the contract incapable of enforcement by arbitration. A further argument could however be made that even then, the party challenging the jurisdiction of the court on the basis of the non-existence of a valid arbitration agreement will still be required to make the objection within the time limited by Article 12(3) (a) of ACA. This is therefore an area deserving appropriate clarification.

Conclusion

This newsletter has argued that even though the Supreme Court of Nigeria may have rightly rejected the appeal by the NNPC in the case under review on the basis of jurisdiction, it left uncertain, questions relating to the effect of novation on arbitration agreements executed in Nigeria. Further, the

newsletter has argued that by failing to comprehensively examine the holding and observations of the House of Lords in *Heyman v Darwins*, the Supreme Court may have neglected observations that could have proved useful in clarifying the position of law in Nigeria. The newsletter has argued that even with the separability doctrine and competence-competence applicable in arbitral proceedings in Nigeria pursuant to Article 12 of ACA, the effect of novation on arbitration agreements still remains unclear. This is therefore an area deserving of further consideration and is not as clear-cut as the Supreme Court in *NNPC v. CLIFCO* had indicated. Should the issue arise in the nearest future, it is hoped that the court will rise to the challenge.

³² Onyema, Emilia *ibid.* See also *Fiona Trust & Holding Corporation v. Yuri Privalov* [2007] EWCA Civ 20.

SETTING THE LIMIT OF COURT INTERFERENCE IN ARBITRAL PROCEEDINGS: STATOIL & ANOTHER V. NNPC & 3 OTHERS – CASE REVIEW

INTRODUCTION

The United Nations (UN) adopted the Model Law of the UN Commission on International Trade Law (UNCITRAL) on June 21, 1985, as a remedy for the tendency of States to give precedence to national laws over international arbitral needs. The model law 'aims to promote harmonisation of national laws, to satisfy the needs of arbitrating parties (and arbitral Tribunals) and to enhance international commercial arbitration'¹. Twenty-three years after coming into effect, about 67 countries have adopted the Model Law.

One of the rather novel provisions of the Model Law is Article V which provides thus: "In matters governed by this law, no court shall intervene except where so provided in this Law." This provision is replicated in Nigeria's Arbitration and Conciliation Act 1988 ("ACA" or the "Act") which borrows heavily from the Model Law as Section 34. The Section precludes a court from intervening in any matter governed by the ACA except where so provided under the ACA.

This provision was recently considered by the Nigerian Court of Appeal in *Statoil & Another. v. NNPC & 3 Others*².

¹UNCITRAL Model Law on Law on International Commercial Arbitration: Explanatory Memorandum prepared for Commonwealth Nations by the Commonwealth Secretariat.

²Suit No: CA/L/758/12. Judgment delivered on 12/07/13



This Newsletter reviews the decision of the Court in the light of current disposition of Nigerian courts to interference in arbitral proceedings, and concludes that the said decision is an unequivocal 'policy statement' which ought to dissuade courts from interference in arbitral proceedings.

Statoil & Another v. NNPC & 3 Others - Brief Facts

Statoil Nigeria Limited, Texaco Nigeria Outer Shelf Limited and the Nigerian National Petroleum Corporation (NNPC) are parties to a Production Sharing Contract (PSC) with an Arbitration clause. Following a dispute regarding the interpretation and performance of the PSC relating to tax, Statoil and Texaco (the Appellants) initiated arbitral proceedings. Relying on a previous decision of the Federal High Court to the effect that tax related disputes are inarbitrable³, NNPC applied to the Arbitral Tribunal for a stay of proceedings on the ground that it could not participate further in the arbitral proceedings as it is inconsistent with the previous Federal High Court decision. The Tribunal refused the application to stay proceedings.

NNPC successfully filed an action at the Federal High Court, which Court granted an Ex-parte Order restraining further arbitral proceedings. Consequently, the Appellants appealed to the Court of Appeal for determination in the main whether the lower court had powers to grant an injunction to restrain arbitral proceedings.

The Appellants argued that Arbitration, being a dispute resolution mechanism alternative to adjudication in regular courts, derives its validity from the consent of the parties. Therefore court intervention should be limited to circumstances

permitted by the ACA⁴ and there is no provision in the ACA that empowers the court to restrain arbitral proceedings by an injunction in the manner the lower court did. The Appellants pointed out that the use of the word 'shall' in section 34 indicates that the provision of the section is mandatory⁵.

Conversely, NNPC argued that the court's inherent and statutory powers to grant injunctions 'in all cases'⁶ is backed by the Constitution and any suggestion that the court cannot issue an injunction in the case of arbitral proceedings fails to draw distinctions between the powers of the court in relation to Arbitration as opposed to the inherent powers of the court to issue injunctive orders. It was further canvassed that courts may interfere in arbitral proceedings in circumstances other than those mentioned in the ACA 'to assist the arbitral process or to ensure fairness and justice'.

The Court of Appeal agreed with the Appellants' construction of section 34 of the ACA and held that where parties have chosen to refer disputes to arbitration instead of resorting to regular courts, a prima facie duty is cast upon the courts to act upon the agreement of the parties. The Court further found that the intention of the legislature in enacting the ACA is to make arbitration an alternative to

⁴These are: section 2 - arbitration agreement is irrevocable except by agreement or leave of court, sections 4 and 5 - stay of proceedings, section 7 - appointment of arbitrators, sections 9 and 10 - challenge of arbitrators, section 13 - interim measure of protection, section 23 - attendance of witnesses, section 29 - setting aside an award, section 30 - setting aside an award in case of misconduct by arbitrator, Section 31 and 51 - recognition and enforcement of award

⁵Section 1 (c) of the English Arbitration Act 1996 provides that "in matters governed by this part the court should not intervene except as provided by this part". The Appellants argued that this is further indication that the ACA (unlike the English Act) bars any interference outside the circumstances stipulated in the Act absolutely. The Court of Appeal agreed.

⁶Reference to section 13(1) of the Federal High Court Act Cap F12, LFN 2004.

³See FIRS V. NNPC & 4 Others; Suit No. FHC/ABJ/CS/774/2011

adjudication before the courts rather than an extension of court proceedings and as a general rule the ACA does not permit the interference of courts in arbitral proceedings.

Justice Akinbami delivering the lead judgment stated that:

“The contention of the Appellants that section 34 of the Arbitration and Conciliation Act is to be interpreted strictly as prohibiting the intervention of the courts in arbitration proceedings is supported by judicial decisions both in Nigeria and in other jurisdictions... In this instant case, the issuance of ex-parte interim injunctions does not fall under the exceptions to section 34 of the Arbitration Act. It is very clear from the intendment of legislature that the court cannot intervene in arbitral proceedings outside those specifically provided. Where there is no provision for intervention, this should not be done.”

ANALYSIS ON COURT'S INTERFERENCE IN ARBITRAL PROCEEDINGS

A number of decisions reached by Nigerian courts exhibit a tendency to uphold the independence of Arbitral Tribunals. However, the decision in the Statoil case is significant because unlike the previous decisions which largely relate to arbitral Awards, for the first time, the Court of Appeal decided on the question of interference in the course of arbitral Proceedings. One area where the courts have upheld the independence of arbitral Tribunals relates to setting aside Awards. While Awards would be set aside on grounds of misconduct and error of law, the courts have held that a court cannot hear a matter that was the subject of Arbitration afresh or give orders in the matter.

In **Bauhaus Inter Limited & Another. v. Midfield Investment Limited**⁷, the Court of Appeal held that:

'The courts' jurisdiction to interfere with the Award of an arbitrator is limited to setting aside the award of an arbitrator or remitting the matter to arbitration for reconsideration. The court has no power to determine any matter the subject of an arbitration proceeding. An application to set aside an arbitral award is an invitation to the court to render the whole arbitration proceedings null and void. The order made is final. In the instant case, the lower court was therefore without jurisdiction to proceed with the hearing of the suit after the setting aside of the arbitral award. The court was without jurisdiction to embark on such an exercise. It has become functus officio as there was nothing left before it to try'.

The decision in Bauhaus v. Midfield supra builds on the decision of the Supreme Court in A. Savola v. Sonubi⁸, where the Arbitrator had among other things rejected the Appellant's claim for the sum of N5, 000.00 being the balance on the sum of N30, 000.00 which he paid the 1st Respondent. The Appellant filed an action at the High Court to set aside the award. The High Court found against the Appellant on all issues except the claim for N5, 000.00 which was transferred back to the Arbitrator for resolution. Upon appeal to the Court of Appeal, the Court of Appeal ordered that the 1st Respondent should pay N5, 000.00 to the Appellant.

On further appeal to the Supreme Court, the decision of the High Court in remitting the claim for N5,000.00 to the Arbitrator was upheld, while the Supreme

⁷(2008) LPELR-CA/A/57/2006

⁸(2000) 12 NWLR (pt 682) 539

Court stated that the Court of Appeal acted wrongly in making the order that the sum be paid to the Appellant by the 1st Respondent. Justice Ogundare stated that:

'The court's jurisdiction to interfere with an award is limited to setting the award aside or remitting a matter to the arbitrator for reconsideration. The court has no jurisdiction to determine any matter, the subject of arbitrator proceedings (sic.)

As the previous decisions of Nigerian courts on the issue of autonomy of Arbitral Tribunals did not clearly delineate the jurisdiction of courts to interfere in arbitral proceedings, the Statoil case is indeed significant and it is hoped that it will greatly discourage interference by courts in arbitral proceedings. Interference by courts delays arbitration thereby defeating speed which is one of the main advantages of arbitration over litigation. In the *A. Savola* supra, the award of the tribunal had been issued in 1985; a year after the dispute arose. The judgment of the Supreme Court was given in 2000, 15 years after the award! In another case, an arbitral proceeding suffered a delay of 12 years⁹. These sorts of delays for which courts are well known do not meet the needs of businessmen who are eager to resolve disputes in the shortest possible time.

International Comparative Analysis

English courts reserve the power to award anti-arbitration injunctions but will do so in only exceptional circumstances and specifically only where it is clear that the arbitration proceedings have been wrongly brought. In *J. Jarvis & Sons Ltd. v. Blue Circle Dartford Estates Ltd.*¹⁰, Jarvis sought a

⁹See *N.N.P.C v. Lutin Investment* (2006) 2 N.W.L.R (Pt. 965) 506

¹⁰[2007] EWHC (TCC) 1262, [19] (Eng.)

stay of arbitration proceedings on the grounds that concurrent proceedings would be in place, that existing proceedings may result in inconsistent findings, and that the arbitration proceedings serve no useful purpose. The court found that it had jurisdiction to entertain the application but refused it while noting that an order restraining arbitration proceedings would only be made in exceptional circumstances.

In *Elektrim S.A. v. Vivendi Universal S.A.*¹¹, in refusing the injunction to restrain arbitral Proceedings, the court reasoned, that under the Arbitration Act, "the scope for the court to intervene by injunction before an award" had been "very limited."

Unlike the English approach, the Swiss legal system is opposed to courts interference in arbitral proceedings. In *Air (PTY) Ltd. v. International Air Transport Association*¹², the Court of first instance of the Canton of Geneva ruled that injunctions restraining arbitration are contrary to the Swiss legal system. The Court held that:

[A]s a matter of Swiss law there is no such thing as a "judicial tutelage" of the courts over arbitrators; quite to the contrary, Swiss law fully implements the principle of "Kompetenz-Kompetenz"¹³ both in its positive effect . . . and its negative effect The jurisdiction of a court to determine whether an arbitration agreement is valid—which cannot in any event lead to an anti-suit injunction—exists only when the arbitration agreement is relied upon as a defence before the court.

The Indian Arbitration and Conciliation Act 1996 mirrors the decision in the above case and

¹¹[2007] EWHC 571 (Comm) [1].

¹²See *Tribunal de Première Instance [TPI] [Court of First Instance] May 2, 2005, Case No. C/1043/2005-15SP (Switz.)*

communicates an intention to restrict the courts with regards to judicial interference. However, the Indian Supreme Court has set precedence which widens the scope of judicial interference in arbitral Proceedings. In the case of *N. Radhakrishnan v. Maestro Engineers*¹⁴, the Court, despite having found that the subject matter of the suit was within the jurisdiction of the Arbitrator due to the existing Arbitration Agreement between both parties, held that allegations of fraud and financial misappropriation can only be settled by the courts. The court based its decision on the assumption that an Arbitration Panel lacked the ability to competently make an Award based on evidence relating to the above issues. This decision shows the Court's willingness in certain instances, to interfere with arbitral proceedings and consequently contrasts section 8 of the Act which mandates the court to refer parties to Arbitration when there is a subsisting agreement between the parties in this regard.

CONCLUSION

While Arbitration exists as an alternative to court proceedings, parties to arbitration have recourse to court in certain circumstances. The delineation of these circumstances involves a delicate balance between judicial intervention and arbitral independence. It is important the courts recognize that arbitration exists to serve the needs of justice and courts should use their powers to support and not supplant the arbitral process. The assistance that the courts offer arbitral tribunals should arise only because the tribunals do not have the power to set the machinery of State in motion for the enforcement of their awards and orders. As Lord Mustill, retired Lord of Appeal, (UK) noted:

¹³The ability of the arbitral tribunal to rule on the question of jurisdiction

¹⁴(MANU/SC/1758/2009)

“Ideally, the handling of arbitral disputes should resemble a relay race. In the initial stages, before the Arbitrators are seized of the dispute, the baton is in the grasp of the courts; for at that stage there is no other organization which could take steps to prevent the arbitration agreement from being ineffectual. When the Arbitrators take charge they take over the baton and retain it until they have made an award. At this point, having no longer a function to fulfill, the arbitrators hand back the baton so that the court can in case of the need lend its coercive powers to the enforcement of the award”¹⁵

The foregoing notwithstanding, the case under review has unearthed an important query which might need judicial pronouncement for guidance. Against a backdrop of the flexibility of an Arbitral process, where an Arbitral Tribunal proceeds to hear and determine an inarbitrable subject matter (for instance constitutional matters, criminal matters, etc) what is the legal status of such an Award?

¹⁵Lord Mustill, 'Comments and Conclusions' in *Conservatory Provisional Measures in International Arbitration*, 9th Joint Colloquium (ICC Publication, 1993) page 118

FAST-TRACK UNDER THE HIGH COURT OF LAGOS STATE (CIVIL PROCEDURE) RULES 2012: A REVIEW

1.0. INTRODUCTION

*"Though the mills of God grind slowly,
yet they grind exceeding small;
Though with patience stands
He waiting, with exactness
grinds He all."*

The above quotation has often been interpreted in legal circles to mean *"the wheels of justice grind slowly but surely"*. Thus, snail-speed seems to typify the pace of most judicial systems, including Nigeria, where litigants are often left with a cold comfort best captured in the phrase *"justice delayed is not justice denied"*.

However, slow dispensation of justice has had its backlash as parties have increasingly found more creative ways of avoiding courtrooms while developing a preference for other seemingly efficient dispute resolutions systems which offer speed as a selling point. Courts in various judicial climes have over the years introduced Fast-Track procedures, the fundamental objective of which is the resolution of issues before the Court of Law within a defined or shortest possible timeframe. These rules are adopted, albeit in different forms, worldwide. The United States Congress utilizes expedited rules for special legislative procedures some of which include



consideration of budget resolutions and reconciliation bills¹. Fast-tracking is also adopted in the judiciary of most states in the US², the United Kingdom³, as well as some international Alternative Dispute Resolution Institutions⁴.

While many in the judiciary may consider the slow and selective nature of the Judiciary to be a virtue in that it guards against hurried pronouncements, scrutiny and debate; others in recent times argue that certain cases require an expedited judicial process. This knave for an expedited judicial process was the back-bone of the Civil Procedure Rules of most States in Nigeria⁵, which resulted in the introduction of "Front-loading"⁶ in 2003 for the first time in the Nigerian judiciary and pioneered by

Lagos State. Another landmark by the Lagos State Judiciary is the introduction of the Fast Track Procedure ("FTP") through the "Practice Directions for the Management of Cases of Fast Track 2008" on February 1, 2008. Four years later, the FTP is now enshrined as Order 56 of the High Court of Lagos State Civil Procedure Rules 2012 (the "Rules 2012") which aims at protecting specific cases from undue delays by procedural and/or technical hurdles in the judicial system.

This Newsletter intends to examine (a) the concept of FTP, (b) when, how, and for whom the FTP is intended, before (c) considering the practicability, profitability, as well as shortcomings of the well intended Rule of Court.

2.0 THE CONCEPT OF FTP

Fast-tracking is not a novel concept to the Nigerian Judiciary, particularly in Lagos State High Courts, as it was first introduced via a Practice Direction. Practice Directions are statements by the judiciary intended as a guide for the courts and the legal profession on matters of practice and procedure⁷. They represent the view of the Judges of the Court issuing them on the subject to which legal practitioners must adhere or ignore them at their peril⁸. The Courts also gave practice directions for fast tracking upon certain matters for reasons of speed and case management. It is important to note however that Practice Directions do not have statutory clout like the Rules of Court, and therefore cannot tie the court in the exercise of its discretion⁹.

Again, Lagos State has blazed the trail in the Nigerian Judiciary by enshrining fast-tracking as a

¹Christopher M. Davis; Expedited or "Fast-Track" Legislative Procedures, February 9, 2011. Available at http://assets.opencrs.com/rpts/RS20234_20110209.pdf, last visited November 2012.

²See for instance Rule 3C of the Nevada Rules of Appellate Procedure, Adopted by the Supreme Court of Nevada in 1973, amended in 2012. Available at <http://www.leg.state.nv.us/courtrules/NRAP.html>, last visited November 2012.

³See Part 28 of the Civil Procedure Rules, available at <http://www.justice.gov.uk/courts/procedure-rules/civil/rules>, last visited November 2012. See also the Asylum and Immigration Tribunal (Fast Track Procedure) Rules 2005; available at <http://www.legislation.gov.uk/uksi/2005/560/contents/made>, last visited November 2012.

⁴An example is the Fast-Track Mediation and Arbitration Rules of Procedure of the International Institute for Conflict Prevention and Resolution. <http://www.cpradr.org>

⁵The overriding objectives of the Rules are "to promote a just determination of every civil proceeding, to construe the Rules to secure simplicity in procedure, fairness in administration, elimination of unjustifiable expense and delay, efficient and speedy dispensation of justice". See the Preamble to the High Court of Lagos State Civil Procedure Rules 2012.

⁶This is a procedure by which a party is expected to file all documents relevant to the case as well as names of witnesses and Statements on Oath well in advance of trial for the information of all parties, and also to guard against any surprise during trial.

⁷See *Oni v Fayemi*, (2008) 9 NWLR part 1089 page 444 paragraph C-E

⁸*Ibid*.

⁹*Ibid* at page 451, paragraph E-F.

Rule of Court under Order 56 of the 2012 Rules; hence giving legal backing to a procedure which is expected to address the problem of congestion of the court dockets. The main objective of the FTP is clearly spelt out in Order 56 Rule 1 of the Rules 2012 as follows:

“The main objective of the Fast Track Court is to reduce the time spent on litigation to a period not exceeding nine months from the commencement of the action till final judgment”

3.0 WHEN AND FOR WHOM?

Under the 2012 Rules, and provided that the action is commenced by a Writ of Summons and an application is made to the Registrar of the court by the Claimant or Counter-Claimant to set the case for FTP, a case qualifies for the FTP in the under-listed circumstances¹⁰:

- The claim is for liquidated money claim or counterclaim in a sum not less than N100,000,000.00 (One Hundred Million Naira); or
- The claim involves a mortgage transaction, charge or other securities; or
- The Claimant is suing for a liquidated monetary claim and is not a Nigerian national or resident in Nigeria and such facts are disclosed in the pleadings¹¹.

3.1 Liquidated Sum

With regards to the first circumstance elucidated above, for a claimant to institute a claim under the

FTP, the sum in dispute must be a liquidated sum of not less than N100,000,000.00 (One Hundred Million Naira). It has been established through case law that the factors for determining a liquidated sum are:

- a. The sum must be arithmetically ascertainable without further investigation.
- b. If it is with reference to a contract, the parties to the contract must have mutually and equivocally agreed to the amount payable on breach.
- c. The agreed and fixed amount must be known prior to the breach¹².

Ordinarily, unliquidated sums sometimes require rigorous processes to ascertain the figures claimed; it is therefore logical that the rules of Court have specially qualified liquidated sums as such that can be brought under the FTP to ensure that time is not unduly spent trying to determine the sum actually being claimed.

3.2 Mortgage Transaction, Charge or Other Securities

Claimants (or counter-claimants) with respect to a mortgage transaction, Charge or other securities can also take advantage of the FTP, and are exempted from meeting the liquidated sum of N100,000,000.00 (One Hundred Million Naira) as stated above. For the purpose of this Newsletter, we shall discuss “Mortgage Transaction” and “Other Securities” under various subheads:

a. Mortgage Transaction

A mortgage is an interest in land created by a written instrument providing security for the performance of a duty or the payment of debt¹³. The central theme behind any mortgage transaction is to ensure the

¹⁰Order 56 Rule 2(1) of the Rules 2012

¹¹Order 56 Rule 2(2) of the Rules 2012

¹²See *Micmerah International Agency v A-Z Petroleum Product Ltd* (2012) 2 NWLR part 1285 page 577

¹³Black’s Law Dictionary, 8th Edition page 1031

prompt repayment of the debt as and when due; and where the mortgagor fails to repay, to use the security to ensure payment. From a plethora of Nigerian case law, many mortgage suits have suffered delay before trial courts, hence stalling the recovery of sums owed and in some cases multi-million dollar business transactions. Thus, the FTP seeks to provide parties to mortgage transactions a definite time frame and ensure speedy dispensation of justice when prosecuting cases before the High Court of Lagos State.

It is interesting to note however that Order 51 of the Rules 2012 provides an alternative avenue for commencing litigation by parties to a mortgage transaction in the form of Originating Summons for foreclosure and redemption. The downside; however, is that Order 51 procedure does not afford the advantage of the FTP which is to reduce litigation time to a period not exceeding 9 months.

b. Other Securities

The term “security” has attracted much controversy in the absence of a generally accepted definition¹⁴. However, Professor Jelili Omotola in his book defined security in the primary and secondary sense¹⁵. He proceeds to explain the primary meaning of security as:

“security for the payment of a debt or claim, either by a right to resort to some form of property, tangible or intangible, for payment or by a guarantee of some

person to satisfy the debt or claim for which another person is primarily liable¹⁶”.

On the other hand, he advances that in its secondary meaning, security may be defined as,

“a document or instrument, which creates or acknowledges an obligation to pay a sum of money, even though it is the original source of the obligation and is not collateral or ancillary to some other obligation. This refers to corporate investment sureties such as shares and debentures issued by companies¹⁷”.

The point must however be made that the terms “Security” and “Securities” are different. Although one may be inclined to regard the latter as the plural form of former, such a conclusion will be misleading. Goode argues that the term “security” should not be confused with the term “securities¹⁸” as he states that “securities” is the term used for investment instruments such as shares and bonds. While there are relationships between the concepts, securities refer to property of a type and not to a legal transaction over property. It is therefore possible to have taken or given a security over certain securities. Thus, Omotola's definition above of security in its secondary sense may be more appropriate as a definition of “securities”.

That being said, it would seem that the use of “other securities” in the Rules 2012 refers to only disputes concerning documents such as shares and bonds for the FTP. Security transactions with respect to Pledges, Hypothecation, Bill of sale and the like may just be barred where the issue is raised.

¹⁴See Omotola J., *The Law of Secured Credit*, Evans Brothers, p.1 (2006); Smith I. O., *Nigerian Law of Secured Credit*, Ecovatch, p. 5 (2001); Woods Goode R. M., *Legal Problems of Credit and Security*, Sweet and Maxwell, p.1 (2003)

¹⁵Omotola J., *Ibid*

¹⁶*Ibid*.

¹⁷*Ibid.*, p. 2

¹⁸Goode R. M., *Legal Problems of Credit and Security*, Sweet and Maxwell, p.1 (2003)

3.3 Non-Nigerian National or Not Resident in Nigeria

The third and final situation under the Rules 2012 favoring the FTP application caters for a special group of people namely:

- a. A non - Nigerian (foreigner) who is resident in Nigeria or not; and
- b. A Nigerian not resident in Nigeria

For this category of people to take advantage of the FTP, their status must be disclosed in their pleadings and the monetary claim must be for a liquidated sum (*however, the ceiling of N100, 000,000.00 does not apply*). In other words, this provision caters for Claimants who are foreign nationals suing upon a liquidated sum, whether such Claimants are resident in Nigeria or not; as well as Nigerians in Diaspora.

This special consideration given to Nigerians in Diaspora by the Rules 2012 may lead to the concession that time management and effective dispensation with respect to a Suit in the home country is of paramount importance. This may not be unconnected with the exorbitant costs associated with prosecuting a suit from outside the country. With respect to foreign Nationals, it is submitted that the Rules 2012 aims at encouraging foreign direct investment in Nigeria by continuously taking proactive steps in ensuring that the legal system provides efficient and swift dispensation of justice in the event of a dispute. Thus, for this class of people, they are able to have their matters settled within the 9 months time frame.

4.0 HOW?

Where a case satisfies the conditions above, the Deputy Chief Registrar shall cause the Originating Process to be marked "*Qualified for Fast-Track*" and

¹⁹Order 56 Rule 3 LCPR 2012.

advise the Applicant on the appropriate filing fees to be paid¹⁹.

The Originating Processes²⁰ under the FTP are to be served on the Defendant within fourteen (14) days of filing²¹. While the Defendant has forty-two (42) days after service of originating processes to file his Defence²², the Claimant subsequent to this, has seven (7) days within which to file a Reply. Within seven (7) days of close of pleadings, the Claimant applies for Case Management Conference (*the "Conference"*), which shall be held daily and adjourned only for the purpose of compliance with Court Orders; provided that the Conference shall be completed within thirty (30) days subject to any extension of time by the Judge²³.

At the close of the Conference, the Trial shall also be held daily, with adjournments as an order of last resort²⁴. Where the court has no other option than to adjourn, it will do so for the shortest possible time²⁵. Subject to the Rules, the entire trial period, including the final address, shall not be later than ninety (90) days from the date trial directions are made.

A comparison as to when a case is initiated under Order 3(2) of the Rules 2012 shows a great deal of benefit when a case is instituted under the FTP. For instance, a Claimant in a non FTP case has 14 days to file his Reply and not 7 days; the Conference in a non FTP case is 3 months as opposed to 30 days; and there is no direction as to the duration of an adjournment under non FTP cases

²⁰Writ of Summons, Statement of Claim, ,Statements on Oath of the Witnesses, List of Witnesses and the List of Documents sought to be relied on at the trial.

²¹Order 56 Rule 4 LCPR 2012

²²Order 56 Rule 5 LCPR 2012

²³See Order 56 Rules 6 & 7 LCPR 2012

²⁴Order 56 Rules 12 & 13 LCPR 2012

²⁵Ibid

5.0 ISSUES

5.1 FTP Application

One of the conditions for assigning a Suit to the FTP under the Rules 2012 is that the Claimant must make an FTP application. Hence, the Rules does not foresee the Defendant making the application for FTP except where he is a Counter-Claimant, subjected to the same caveats as an FTP Claimant²⁶.

It is often assumed that a Claimant is more likely to institute a frivolous suit or exaggerate their claims so as to meet the monetary demand of the fast track categorization while a Defendant is more likely to waste the time of the Court. However, a Defendant is left in a precarious situation where a Claimant with ill motives institutes a Suit which meets the criteria of the FTP but deliberately refuses to apply for same hoping to take advantage of the snail speed of the normal run of court trials. The Defendant who would want an urgent determination of such a case is handicapped due to the fact that the Rules prevent him from applying for FTP in his capacity as a "Defendant" especially if he has no counterclaim or has a counterclaim not meeting the FTP conditions.

Directly flowing from the preceding is whether a Judge can *suo motu* order an FTP. Again, this is not provided for in the Rules as the application for FTP is made by the Claimant to the Registrar. It is however hoped that the FTP Rules would evolve to a stage where Judges can *suo motu* based on the pleadings before them can order a case to be assigned to a Fast Track Court where such a Claimant meets the criteria but has not applied for same.

5.2 Delivery of Judgment

Order 56 Rule 15 of the Rules 2012 provides that:

"In all fast track cases, the Judge shall endeavor to deliver judgment within sixty

(60) days of the completion of trial."

A first read of the above provision may appear an unconstitutional abridgement of the time provided for in Section 294 (1) of the Constitution of the Federal Republic of Nigeria 1999 (As Amended)²⁷ which provides:

"Every court established under this Constitution shall deliver its decision in writing not later than ninety days after conclusion of evidence and final addresses..."

The question therefore is whether an inconsistency can be said to have arisen between the Rules 2012 and the 1999 Constitution. It is important to note that the 1999 Constitution provides that judgment be delivered *not later than* ninety (90) days; while, the Rules 2012 provides that the Judge should *endeavor* to deliver judgment within sixty (60) days. "*Not later than*" means it can be earlier than, while "*endeavor*" does not impose a specific and mandatory duty on the Judge to stick to sixty days. To that extent therefore, there exists no inconsistency between the Rules 2012 and the 1999 Constitution on the timeframe for delivery of judgment.

However, a lacuna can be said to exist as there is no specific provision with particular respect to timeframe for Rulings on interlocutory applications. A practical illustration is evident from several experiences in Nigerian Courts where a Ruling on an application can be pending before the Court for several years. Thus, it is imperative that a future review of the Rules should include a time frame for delivery of Rulings under the FTP.

²⁶See 3.0 above

²⁷Referred to as the 1999 Constitution

6.0 Conclusion

It is inevitable that disputes would always arise. However, the resolution of such disputes nonetheless is integral to commercial and socio-economic development. It is certainly not the intention of the judiciary that adjudication takes forever, but in the bid to ensure that judgment is delivered within the time stipulated by the rules of court, it may not be unexpected that salient matters in the processes may be glossed over and not given the required meticulous attention.

With the rapid increase in investment in Africa, and by extension the foreign direct investment in Nigeria evidenced by numerous commercial transactions daily that spin into millions of Naira and USD, the FTP could not have come at a better time to position the Nigerian Judiciary as flexible and dynamic. It is quite obvious that the past two years have seen more commercial litigation than past years put together in Nigeria. Legal Practitioners with flare for commercial practice have been expected to provide detailed/specialized or tailored legal services to suit the needs of high brow clients.

While the noble cause propelled by the FTP under the 2012 Rules is commendable, abuse remains a possibility. Considering the seeming peculiarity of fast track cases, it neither has to be repeated or stated that no separate Court is created, built nor is any single judge assigned to the determination of only fast track matters. The judge remains the same over the regular matters and the fast tracked matters; his workload remains the same and maybe even more. There remains the problem of archaic system of court adjudication, corruption, and lack of modern case management techniques, inadequacy of efficient judicial personnel; most

matters coming under fast track being sensitive and high profile matters. The efficacy and practicality of the FTP is therefore left to be seen.

In concluding, it is suggested that fast tracking be made available to other special subject matters including Custody of Children, certain criminal appeals (especially felonies carrying a sentence of death or life imprisonment) and matters brought under the Human Rights Enforcement Procedure Act. The intention behind the Rules 2012 is highly commendable and should be replicated in all courts in Nigerian judicial hierarchy with particular emphasis on the Court of Appeal and the Supreme Court. Perhaps a more radical approach could be a calculated attempt to place limits on the exercise of the right of appeal by litigants as obtainable in some advanced jurisdictions.





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