

LEGAL ISSUES IN FINANCING OF THE ACQUISITION OF FPSOs

INTRODUCTION

Floating Production Storage and Offloading vessels (FPSOs) are specialised vessels used in the production and storage of crude oil located in shallow and deepwater fields offshore. They are a relatively new concept in the maritime and offshore oil and gas industries with the construction of the first dating back to 1977 used by Shell on its "Castellion field" in Spain Mediterranean. FPSOs are now being used in a number of deepwater fields all over the world and they are becoming increasingly popular as they form an economic and convenient means of developing offshore fields and also sometimes marginal fields, located far away from any existing infrastructure. Currently there are about 85 FPSOs operating in different parts of the world.

Acquisition of FPSOs usually involves awarding a contract for the construction of a new FPSO or conversion of an existing VLCC into an FPSO. The methods of acquisition include outright ownership/purchase of the FPSO and charter/lease of the FPSO. There are of course several hybrids between these two forms.

Financing of FPSOs

Whatever the preferred mode, acquisition of FPSOs is a capital-intensive project consequently; financing is a subject of utmost importance.

There are several ways an oil company can finance the acquisition of its FPSO.

1. Self-financing; and
2. Alternative Financing – this includes any other form of financing other than self-financing.

Self – Financing

This option is available to an oil company that decides to finance the acquisition of its FPSO itself. This would in its simplest form entail the joint venture partners i.e. both the host government and the oil company or companies financing the acquisition from their own resources in ratios proportionate to their equity holdings in the concession. However, this may not always work out in practice due to possible cash constraints on the part of one or more of the parties particularly the host government.

Alternative Financing – Lending

Lending

The joint venture partners may opt for loan financing from banks/financial institutions to finance the acquisition of their FPSOs. There are several issues financiers should consider in their decision to finance a FPSO project.

Project Review

This will involve a legal, financial, economic and technical review of the project. A legal review will consider the laws and tax system in the site country and the effect of the system on the project. The legal review should also address and make provisions for remedies and method of resolution of disputes, which are likely to arise due to potential project risks pertaining to completion, resource, operating, market, currency and political risks.

Contractual structure issues, which entail a review of all the documentation relating to the project including the concession agreement, construction contract, financing agreement and crude oil sales agreement to ensure that the risks of the project are properly allocated between the parties should be addressed.

Security Issues

The type of security obtained and the remedies available will largely depend on the laws of the jurisdiction involved. In a normal asset purchase transaction, security is usually taken for an offensive purpose, to enable the lender to sell the asset in the event of a default. However, this is different with project finance. In obtaining security for financing an FPSO, the primary objective of the lenders should be more defensive to ensure that the security taken would protect them from actions by unsecured or junior creditors of the company, rather than to sell off the unit because it may not be easily marketable.

Secondly, security can be obtained to enable the lenders to take over the operation of the FPSO for the realisation of the project, rather than just selling off the FPSO and using the proceeds to repay the loan.

The kind of security usually taken to secure the loan include:

- a mortgage on the FPSO;
- bank guarantees from the oil company or the construction contractor to cover repayment of instalments in the event of a bankruptcy;

- assignment of the concession (this will require the consent of the host government);
- assignment of the proceeds of the crude oil;
- fixed and floating charge on the assets of the lender/oil company;
and
- establishment of a trust account for the receipt of the proceeds of sale of the crude oil e.t.c.

Security – Checklist

The lenders lawyers should establish the following:

- Which asset the borrower owns and which it merely has a right to use under a lease/licence;
- What asset of the borrower can a fixed charge/security be created;
- Whether floating charges can be created over the borrower's asset;
- Whether security can be created over future assets i.e. assets to be acquired by the borrower after the creation of the charge;
- Whether security can be created over movable assets without the physical transfer of those assets to the mortgagee or pledgee;
- What degree of control the chargee must exercise over the asset to constitute a fixed as opposed to a floating charge;
- Whether there are restrictions on foreigners taking security over land;
- What creditors, will by law, be preferred over secured creditors;
- Whether third parties or liquidator can interfere with the grant of security or with its enforcement;
- Whether, on a default, the lenders will be able to appoint a receiver over the assets;
- Whether the bank/lenders will be responsible for the receiver's action or whether a receiver can be appointed an agent for the borrower.

Brief overview of Security Under Nigerian Law

Some important features of Nigerian security law are as follows:

- security can be taken over all types of assets both present and future assets.
- security can be taken relatively simply by means of a floating charge over all of a company's asset, which allows the company to continue to deal with those assets in the ordinary course of business.
- security can be taken over all classes of assets without taking possessions i.e. non-possessory security interest.
- Enforcement including by way of sale can be effected without involving the court, a secured creditor can also operate an asset by taking possession by appointing a receiver.
- Certain types of security (fixed charge/security) will rank ahead of preferential creditors.
- Only minimal fees and duties are payable on a creation of security and only the normal transfer taxes (stamp duty) are payable on its enforcement.
- The trust concept allows interest in security to be transferred relatively simply and in a secured syndicated loan; the security is usually vested in the name of an agent bank as agent and trustee for itself and other banks.
- There is a central registration system for most categories of security interest, which enables creditors and prospective lenders to check what security a company has already created in favour of other creditors.

Peculiar security issues affecting the financing of FPSOs

Ownership in petroleum in situ in most countries is vested in the host government and typical requirements of the petroleum authorities in those countries are:

- Approval of the field development programme - any programme for the development of a petroleum discovery i.e. field development programme (FDP) must be approved by the relevant petroleum authorities prior to the award of the contract for the

construction of the FPSO upon approval, the operator will be required to apply to the petroleum authorities for all permits and approvals necessary for the different phases of the project.

- Revocation of licence - A licence can be revoked on various grounds including the appointment of a receiver over the licensee, a breach or non-observance by the licensee of any of the terms and conditions of the licence and a change in the control of the licensee. A change in control will include lenders with security over the shares in the licensee exercising their enforcement remedies under that security.
- Prohibition on assignment - A licensee wishing to give security over his interest will require the consent of the Minister of Petroleum. The consent if given will state that a further consent will be required for any enforcement of the security interest. However questions arise as to the kind of security that can be given over a company's interest in an oil or gas field. The security is over the company's interest in a bundle of contractual rights, the most important being the company's rights under the concession/production licence and the JOA as opposed to security over the minerals in the ground.

Conclusion

FPSOs are going to get more popular in the field development programs of oil producing countries all over the world as oil companies continue to prospect for crude oil in deep and ultra deep waters offshore. The method of acquisition suitable to each company would be determined to a very large extent by the company's corporate structure, needs and or preferences. For instance a multinational oil company with a large field with huge reserves may require a huge FPSO for the production of the field, this may not necessarily be adaptable to the needs of a small oil company and failure to realise this could of course lead to disastrous consequences. Legal issues pertaining to financing the acquisition of FPSOs have been discussed and banks and other financial institutions and oil companies and other investors will do well to address the same, subject to the peculiarities of the proposed geographical location of the FPSO and or security asset before executing the final version of the financing agreement.

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