Mitigating risks in the current oil industry crisis

By Oneyka Ojogbo

6 May 2020

The compounding effects of coronavirus and oil industry disruptions pose unique and significant challenges, particularly on the African continent where the economies of producing countries are largely dependent on oil revenues.

Oneyka Ojogbo

The budgets of countries like Nigeria, Equatorial Guinea and Angola have been made mostly impractical and with annual budgetary goals now unachievable due to these unprecedented events. Nigeria, the continent's most populous country and its largest oil producer, is expected to cut its 2020 national budget by $4.9bn. That budget was prepared based on the estimation of crude prices at $57/barrel. With the Brent price at slightly over $20 today, the country is most probably headed towards a recession, absent quick and miraculous interventions like the discovery of a Covid-19 vaccine.

As more countries remain locked down and businesses remain shut because of the pandemic, the demand for oil will remain low, leaving prices equally low. The continuing disruption in the industry distribution chain and the businesses of international oil and gas companies which the African oil market relies heavily on has caused a direct and immediate impact on the local market. Oil and gas producers and service companies from Port Harcourt, Luanda to Juba and emerging producers like Senegal and Mozambique are now faced with a myriad of financial and legal issues. Oil projects have either been suspended, like in the case of BP which issued a force majeure notice to delay taking delivery of the LNG facility for the African Tortue Ahmeyim project in Senegal; or simply terminated like the Tullow Deepwater drillship contract in Ghana.

It is now critical for companies operating in the African oil and gas sector to assess the impact of the pandemic and industry disruptions on their local operations and contractual obligations. With no end in sight, companies need to consider and take all necessary actions to mitigate all associated risks.

I have identified below some crucial issues relating to contracts and local operations.

Contracts

The pandemic and oil price crash likely to cause some countries and businesses to suffer great financial challenges, there may be a need for oil producing governments to reconsider their position under oil contracts. International oil companies (IOCs) and foreign service companies may also be unable to meet their capital spending commitments. Potential production cuts and reduced demand could affect their ability to meet up with repayment obligations under financing instruments. Consequently, it is possible that parties will seek to terminate or renegotiate existing contracts. Companies should consider their position and begin to prepare for this possibility.

Key considerations when renegotiating the contracts during this period:

- Both parties' capacity to fulfil capex commitments in joint venture or production sharing contracts;
- Crude prices and global demand for crude which will affect future receivables;
- Ability to obtain other financing post-Covid-19;
- Political and economic stability in host country;
  Any changes in law that affect the stability of the current contract;

- Local content obligations; and
- The opportunity cost of the deal.

Another set of contracts that may be affected are those with Independent contractors and service providers. With the mandatory shutdown of business across sectors, subcontractors may be unable to deliver on their contracts commitments and obligations. It is important to review all contracts and confirm the conditions of these contractors. This will prepare the company to implement necessary measures to cushion any defaults until such a time that specific contractual remedies can be sought.

Tax implications and reliefs

Despite the negative impact of the pandemic and falling crude prices on company operations and finances, companies in the sector still have huge tax obligations to the government which must be fulfilled. Some countries are currently offering tax reliefs and fiscal packages to companies to mitigate any adverse economic impacts.

It is important that companies determine their eligibility for these reliefs. For example, the government of Equatorial Guinea has granted some tax reliefs which include a reduction in the minimum income tax from 3% to 1.5%. However, this relief does not currently apply to companies in the oil and gas sector. Other governments have provided some extension for tax payments. It is likely that governments may offer specific reliefs and tax exemptions to oil and gas companies going forward if the industry woes continue.

Force majeure provisions

An issue may arise where a party is unable to fulfil its contractual obligations. In such an instance, the company may find some reprieve in the force majeure provision. Force majeure relieves a party from liability for non-performance under a contract and it generally refers to the occurrence of an event which is outside the control of the party affected by such event and which prevents that party from performing its obligations under the contract. It is usually provided in and interpreted according to the agreement. Force majeure will never be implied into an agreement. So, the definition of force majeure, the events that constitute the force majeure, the effects of the force majeure on the contract (including suspension of any obligations or eventual right to terminate) and the procedure to report a force majeure event to the other party are very important to consider when trying to determine whether a party may be able to take advantage of this provision and to what extent it can be used.

With the impact of the pandemic on operations, it comes as no surprise that several companies in the industry have already declared force majeure. Tower Resources declared force majeure on its Thali offshore Cameroon license for instance, and BP sent a notice of force majeure to Golar LNG seeking to delay the receipt of the Gimi FLNG facility. Shell which was lauded for ground-breaking success at Forcados, Nigeria, had also declared force majeure after the closure of its pipelines. However, the force majeure has since been lifted and the Forcados Oil Pipeline system, the second largest in the Niger Delta, has been reopened. Should the current situation persist, it is likely that more companies will look to suspend their obligations using force majeure clauses.

Oil and gas companies must review their contracts, including PSCs and services contracts, to determine whether they can suspend their obligations under the force majeure clause and which obligations can be suspended during the pendency of the force majeure event. It is important to note that while some force majeure clauses permit the suspension of all obligations, others only cover the suspension of non-monetary obligations.

Employment and employee safety

At this crucial period, companies may face challenges with maintaining their staff on ground and ensuring that adequate levels of health and safety measures are always provided. Companies must consider the current employment regulations and measures applicable in their countries of operation and ensure strict compliance. It may be illegal to terminate employment contracts at this point as is the case in Senegal. The company could consider the option of furlough but in countries such as Gabon, the approval of the work inspection will be required for this.

It becomes prudent to discuss with labour experts in the country and closely monitor the proclamations of the authorities for any changes in laws or regulations affecting labour.

In countries where there is no lockdown and businesses are still in operation, the company must ensure that adequate Covid-19 policies and health measures are put in place to protect the employees. The protection of workers in the workplace during this period cannot be overemphasized. Some countries have swiftly adopted health and safety laws/regulations to deal with the spread of the pandemic. These laws may be applicable in workplaces. The company needs to consider these provisions and effectively implement them. Countries such as Equatorial Guinea have issued specific Covid-19 work policies to ensure the safety of workers. Companies are therefore advised to adopt protocols that, at the minimum, comply with the government prescribed policy.

The world will continue to deal with the adverse economic impact of this pandemic and the declining crude price for years to come. Certainly, many aspects of our lives and how we do business will never remain the same. Africa will be heavily impacted by this incident and will require radical government responses to push through. African oil and gas players ought to carefully assess the situation and take the necessary steps to alleviate the short- and long-term effects on their operations.

ABOUT THE AUTHOR

Oneyka Ojogbo is an associate attorney at Centurion Law Group.