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Industry in Focus

Surviving the Global Oil Crisis: Is the Solution in the Past?

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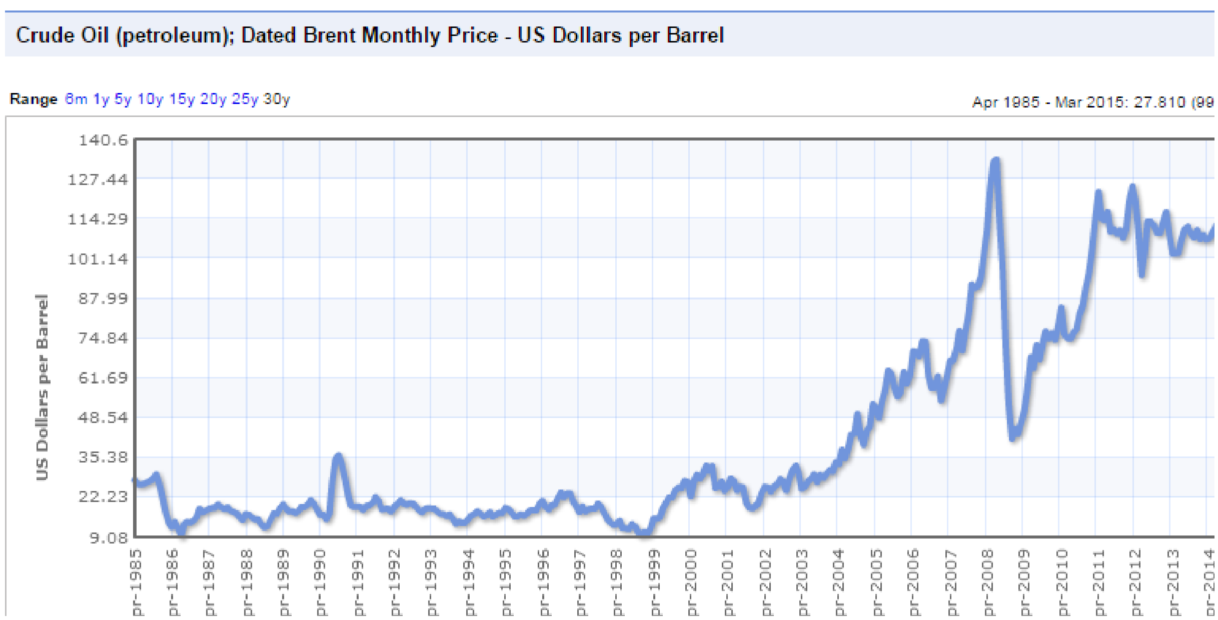
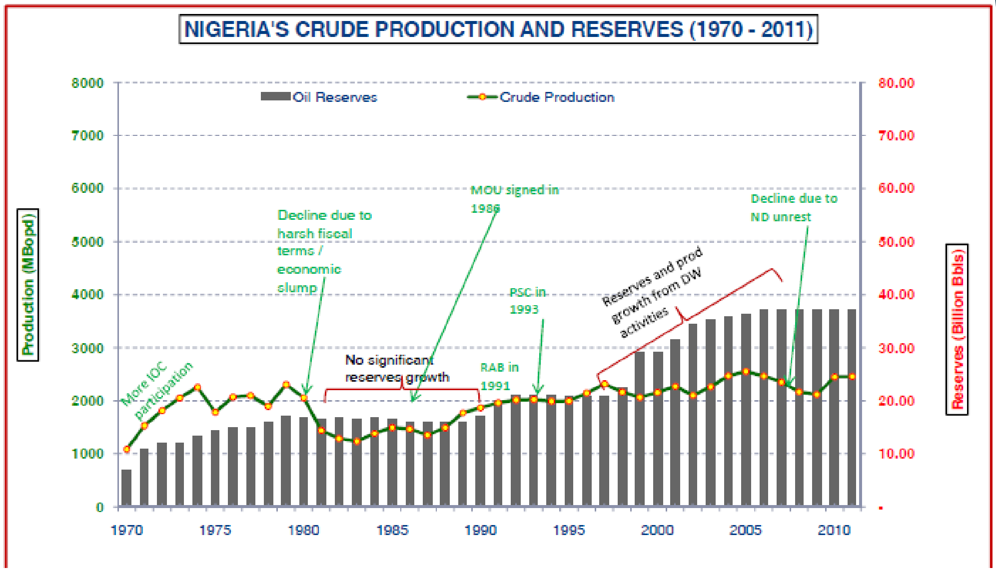
Nigeria has been on the international spotlight for so many reasons, one of which is the effect of the fluctuating global oil prices on her petroleum mono-economy. Paul Hawken once said that ***"good management is the art of making problems so interesting and their solutions so constructive that everyone wants to get to work and deal with them."*** Another interesting quote says "we must study the past if we must understand the future." These suggest that in order to overcome her present challenges and reposition in petroleum sector for optimum performance both for the government and other stakeholders, Nigeria perhaps needs to revisit its past for possible directions on the way forward.

In 1986, a Memorandum of Understanding (MoU) between the Nigerian National Petroleum Corporation (NNPC) and the International Oil Companies (IOCs) was signed and the concept was a major policy modification in the Nigerian oil and gas sector which was introduced by the Nigerian Government to ensure that the participating companies are guaranteed a minimum level of profitability after tax and royalties on their equity crude. Besides the minimum profit margin after tax and royalty on equity crude, in 1991, a Reserve Addition Bonus (RAB) clause was introduced into the revised MoU which served as an incentive for IOCs to embark on aggressive exploration and subsequently boost the country's reserve. However, in 2004, drastic changes in the circumstances leading to the memorandum coupled with issues of fraud led to the termination of the MoU.



Source: World Bank

In 1986, when the memorandum was implemented, the Brent oil price was $9.56 USD per barrel, the nation's reserve was 15 billion Bbls and crude production was 1.5 MBopd. With the introduction of the RAB in 1991, Brent Crude Oil price was $19.16 USD and Nigeria's reserve was 20 billion Bbls with a crude production of 2 MBopd. Fast track to 2004 when the MOU/RAB was terminated, Brent Crude Oil price was then $33.8 USD, a reserve of almost 24 billion Bbls and production of likewise almost 2.3 MBopd. Over the years, the price of crude rose to as high as $133.9 USD in July 2008. However, Brent Crude Oil price has continued to fluctuate, suffering a drastic fall to about $50 in January 2015, its lowest level since the financial crisis in 2009, but has since seen a little recovery to about $65 as at May 4th, 2015.



Source: BP 2012 Statistical Review

These facts confirm that at a time when the Brent Crude Oil was $33.8 USD in 2004 and the MOU/RAB was terminated, the nation's reserve and crude production witnessed a significant increase and has not increased ever since. Also, within the last 10 years, no major discovery has been made in the country and our current reserves are depleting. ***Former Managing Director of the Shell Petroleum Development Company of Nigeria Limited (SPDC), Mutiu Sunmonu, argued that "to maintain levels of production, Nigeria needs to add 250,000 barrels per day, requiring about 10-15 billion U.S. dollars."*** We are currently a long way from this mark because local and international operators do not have enough incentives to invest largely in exploration at this time.

The MoU/RAB thus appears to have been a good concept which might have positive impacts on the Nigerian economy if policy guidelines with a proper risk assessment frame work are put in place and if the level of incentives for the IOCs is reviewed. Advanced technology platforms by regulatory agencies will also enable a close policing of the memorandum.

Furthermore, ***President-Elect of the Nigerian Association of Petroleum Explorationists (NAPE), Nosa Omorodion***, believes that the nation could weather the negative impact of the current crisis arising from the drop in price of crude, adding that ***"Many years ago the government came up with the concept of a MoU to avoid crisis."***

With the current situation of the global oil prices and the stagnation in discovery of new reserves, could the MoU/RAB be a solution to the impact of the current crisis on the Nigerian economy and a boost in the nation's crude reserves? Please click here to participate in our opinion poll.

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For further information:

CENTURY GROUP

T: 234 (0) 1-2715374, 2719586 | E: sales@ceslintlgroup.com
W: www.ceslintlgroup.com