Natural Resource Governance Institute

Securing Fair Value from Nigeria's DSDP Contracts

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This briefing explores the Nigerian National Petroleum Corporation's (NNPC) options for ensuring that its 2017 direct sale of crude oil and direct purchase of products (DSDP) contracts deliver fair value for Nigerian citizens. NNPC signed its first round of DSDP contracts, worth up to 330,000 barrels of oil per day (b/d), in spring 2016. These deals replaced the controversial oil-for-product swaps it entered into under the Goodluck Jonathan administration (2010-2015)—though, as this note will show, they too are a type of swap. This year the state-owned company will allocate several hundred thousand b/d of the country's oil to the other parties to its new DSDP agreements in exchange for imported fuel, mainly gasoline and kerosene. In February NNPC received 128 bids for the new contracts in a publicized tender. The deals are supposed to start by 1 April and last for one year.

NNPC's swaps are big transactions with major public revenue implications. The DSDP contracts consumed 252,083 b/d of oil worth USD 3.4 billion between February and November 2016—or 42 percent of all the oil NNPC reported as lifted by the government during the period.[1] Nigeria has been relying almost totally on the deals to satisfy the country's demand for gasoline and kerosene.

NNPC's use of swaps has also been prone to mismanagement in the past. In the NRGI 2015 report *Inside NNPC Oil Sales* two colleagues and I analyzed the Jonathan-era swaps in detail and found the contracts contained many unclear or unbalanced terms and were sometimes poorly managed.[2] The report also raised questions about some of the companies selected, and concluded that NNPC's oil sales system during this period suffered from high corruption risks and failed to maximize returns for the country's citizens.

This history shows the need for greater discussion, understanding and oversight of NNPC's use of swaps. I have found that the new DSDP program features significantly better terms, transparency and management compared with preceding agreements. This appears consistent with other improvements in oil sale governance seen since the change in government.[3] Nonetheless, NNPC and the DSDP contractors still control the flows of information and accountability around these large and valuable but niche deals. NNPC still publishes only high-level figures for the crude lifted and products supplied, and whether the contract holders have supplied enough fuel is determined during closed-door, periodic reconciliation

1 Figures derived from NNPC, *Monthly Financial and Operations Report*, December 2016, tables 2.3.1, 2.4.2.
2 Aaron Sayne, Alexandra Gillies and Christina Katsouris, *Inside NNPC Oil Sales: A Case for Reform in Nigeria*, Annex B (NRGI, 2015).
3 Aaron Sayne, "Tender Moment for Oil Sale Governance in Nigeria," NRGI, 19 October 2016.

meetings between the parties.[4] This leaves the parties to the agreements essentially free to police themselves. The terms of the DSDP deals also remain undisclosed. This goes against a growing trend of extractives contract disclosure in resource-rich countries—and an earlier pledge by top NNPC management to publish all contracts.[5]

This briefing offers analysis and recommendations for how NNPC could improve the terms and oversight of its 2017 DSDP deals. Conclusions are based primarily on analysis of an example of the 2016 DSDP agreements ("the 2016 DSDP contract") that I obtained, other relevant documentation, and a range of interviews and consultations with industry players and technical experts. I also obtained and reviewed a copy of the term sheet for the new contracts that NNPC sent to selected bidders last month ("the 2017 DSDP term sheet").

Prior to publication, I sent written questions to three top NNPC officials in attempts to solicit the corporation's feedback on our findings and recommendations, along with any further views and perspectives they wished to offer. On publications written since the 2016 change of government, NRGI has found NNPC willing to engage and provide useful information. One of the officials promised to send written responses but ultimately did not after several follow-up inquiries. The other two officials did not respond.

BETTER SWAPS, BY ANOTHER NAME

The 2016 DSDP contract is structurally the same as one type of swap signed during the Goodluck Jonathan years, with some considerably better terms for the government. The 2017 DSDP term sheet also proposes the same basic swap structure. Specifically, I found few major structural differences between either of these and the refined products exchange agreement (RPEA) signed in early 2011 between the NNPC subsidiary Pipelines and Product Marketing Company (PPMC) and Duke Oil, NNPC's wholly owned trading company ("the PPMC-Duke RPEA").[6] Winners under both the RPEA and the DSDPs receive allocations of Nigerian government oil in exchange for delivering equivalent values of gasoline, kerosene or gasoil (diesel) to NNPC. This is despite earlier claims that government was "replacing" the swaps with a fundamentally new type of transaction with foreign refiners.[7]

NNPC most likely has saved itself and Nigeria considerable money, fuel and controversy by returning to RPEAs. A new type of overseas refining deal almost certainly would have had more potential revenue loss than this kind of swap. Whether Nigeria won or lost from some new type of deal would have depended on highly technical, market-based terms and variables that few officials could have

4 Author interviews, traders and NNPC officials, 2016. Recently-released research by NRGI found that among 51 EITI implementing countries and one subnational region, 29—that is, well over half—have disclosed at least some of their extractives agreements, and several more are taking concrete steps to join their ranks. For more information, see Rob Pitman and Don Hubert, *Past the Tipping Point? Contract Disclosure within EITI* (NRGI: 2017).

5 "NNPC contracts to be made open to public – Kachikwu," *Premium Times*, 25 September 2015.

6 For more on the structure of the PPMC-Duke RPEA, see Sayne, Gillies and Katsouris, *Inside NNPC Oil Sales*, B7-8. A copy of the contract is available on NRGI's webpage for *Inside NNPC Oil Sales*.

7 NNPC, "Press Release: Direct Sale-Direct Purchase to Replace Crude Swap, Takes off March – Kachikwu," 2 February 2016.

effectively negotiated or monitored.[8] Illustrating these risks, NNPC under President Jonathan abandoned the RPEA and entered into offshore processing agreements (OPAs) that were case studies in what could go wrong. The OPAs were much more complex and opaque than RPEAs—and, it turned out, more prone to abuse.[9] In *Inside NNPC Oil Sales* we estimated that just three of the unbalanced terms in one of the OPA contracts together cost NNPC $381.3 million (or $16.09 per barrel of crude lifted) in 2011.[10] After the change in government, NNPC canceled all of its OPAs in August 2015, stating they were "skewed in favor of the companies such that the value of product delivered is significantly lower than the equivalent crude oil allocated."[11] Officials have since claimed the switch to DSDP deals would save Nigeria between $500 million and $1 billion in the first year.[12] These estimates seem more than reasonable given the OPAs' exorbitantly high costs.

This time, NNPC chose to recycle elements of the RPEA, rather than inventing a new type of swap. Viewed side-by-side, it seems the PPMC-Duke RPEA served as a template for drafting the 2016 DSDP contract. This is not bad: in *Inside NNPC Oil Sales* we concluded that the Duke agreement could be a decent starting point for creating future fuel import deals, provided that NNPC tightened some unbalanced, unclear or conflicting terms that either unduly rewarded the companies or gave the parties too much discretion to negotiate outcomes during the reconciliation meetings.[13]

To its credit, NNPC made quite a few such improvements in the 2016 DSDP contract. For example, the parties must now preserve records from the deals for longer periods (five years instead of only one).[14] The contract contains tighter rules for calculating demurrage—the extra payments that NNPC owes contract holders when they cannot discharge fuel from waiting ships within an agreed time, usually because of some failure on NNPC's part to arrange for prompt discharge.[15] Demurrage was a major point of revenue loss in the Jonathan-era swaps.[16] The 2016 contract also includes an industry-standard list of exemptions from demurrage,[17] and the Buhari administration seems to be managing the fuel discharge process more efficiently than in the past.[18] Viewed more broadly, the 2016 contract is more carefully drafted than the PPMC-Duke RPEA, with more defined terms, more guidance on interpretation and fewer conflicting provisions.[19]

8 These could have included: complex formulas used to determine the fuel the refiner owes per unit of oil received; the size of per-unit processing fees that refiner can charge; rights given to the refiner to demand certain grades of crude oil at certain times; options to trade unrefined crude, use alternative refineries and substitute one type of fuel for another; grants of exclusivity or priority status to a refiner; the stringency of fuel quality specifications; and provisions apportioning transportation responsibilities and costs between the parties.

9 Sayne, Gillies and Katsouris, *Inside NNPC Oil Sales*, B22-38.

10 Id., B27.

11 NNPC, "Press Release - NNPC Cancels Contract for Delivery of Crude Oil to Refineries," August 26, 2015.

12 NNPC, "Press Release - 128 Companies Bid for NNPC DSDP Crude Import Programme," 2 February 2017; NNPC, "Press Release: Direct Sale-Direct Purchase to Replace Crude Swap, Takes off March – Kachikwu," 2 February 2016.

13 Sayne, Gillies and Katsouris, *Inside NNPC Oil Sales*, B13.

14 2016 DSDP contract Art.16.1-2; c.f. 2011 PPMC-Duke RPEA Art.12.

15 Most notably, the 2016 DSDP contract stipulates that demurrage payments do not start to accrue until 120 hours after a vessel tells NNPC it has arrived (called "tendering notice of readiness"). 2016 DSDP Contract Art.7.5. The PPMC-Duke RPEA gave NNPC only 42 hours. 2011 PPMC-Duke RPEA Art.7.7.

16 Sayne, Gillies and Katsouris, *Inside NNPC Oil Sales*, B20-21.

17 2016 DSDP contract Art. 12.3.

18 Under Jonathan, vessels carrying fuel due under the swaps routinely sat offshore Lagos for weeks or months before being allowed to offload their cargoes. Since the DSDP regime started, many ships have arrived, discharged and sailed within days. Conclusion based on reviews of satellite data and author interviews with oil company and NNPC personnel, 2016.

19 For example, two different articles in the PPMC-Duke contract said variously that Duke had 30 and 60 days to deliver fuel. 2011 PPMC-Duke RPEA Art.2(iv), 3(B).

The 2016 DSDP contract also contains measures that aimed to avoid past problems with Nigeria's fuel import systems, though some argue these provisions went too far. This especially concerns some of the contract's protections against losses that can happen during fuel deliveries. The companies that hold DSDP contracts must deliver fuel into the existing supply chain for Nigerian fuel imports. As past scandals have revealed, the complexity and opacity of this supply chain has served a number of entrenched, lucrative rackets around shipping, distribution and sales of fuel. These include smuggling, selling locally refined products back to NNPC at import prices, under-delivering and outright theft.[20]

Some provisions in the 2016 contract respond to these risks in ways that seem non-industry-standard and overly strong. For example, the agreement includes steep penalties for late delivery of fuel, including heavy fines and possible automatic termination of the contract.[21] This could be read as a reaction to events leading up to Nigeria's 2015 presidential elections, when some swap contract holders delivered fuel months behind schedule.[22] But a range of industry sources and consultants (including some who are not competing for 2017 contracts) thought the new terms were excessive, given that there can be legitimate reasons for lateness.[23] Elsewhere, the 2016 contract says NNPC shall summarily reject delivered fuel that fails quality checks instead of giving the supplier an opportunity to retest the cargo and correct any defects.[24] It seems NNPC officials have learned from the past and are trying to protect company and national interests against malpractice. According to some accounts, NNPC management has made progress in sanitizing parts of the fuel supply chain over the last two years.[25] But ultimately, draconian contract provisions like the ones just discussed will do less to stem losses under the DSDP contracts than choosing capable, reputable suppliers and managing the agreements with care and integrity.

AREAS FOR POSSIBLE FURTHER IMPROVEMENT

My research found three areas where NNPC could strengthen the terms and management of its DSDP contracts in 2017, despite improvements over the old swaps already made last year. These are:

1. Pricing

Fair pricing is critical to getting decent value from a barter arrangement like the DSDP. This is because the amounts of gasoline or kerosene the contract holder has to deliver is "based on the value of the crude oil" it receives.[26] In other words, the products supplied have to be of equal value to the crude, minus certain agreed costs and fees. Every quarter, the parties are supposed to determine whether the contract holder has met its obligations by reconciling invoices for products it supplied against NNPC's invoices for the oil the contractor received.[27] Under this system, Nigeria necessarily would get less fuel if the crude was priced low or the products high.

20 For more on these issues, see Sayne, Gillies and Katsouris, *Inside NNPC Oil Sales*, B39-48.
21 2016 DSDP contract Art. 3.4.
22 Sayne, Gillies and Katsouris, *Inside NNPC Oil Sales*, B45-47.
23 These include bad weather, vessel breakdowns and problems at the port where the fuel was loaded on the ship. Author interviews, 2017.
24 2016 DSDP contract Art. 8(4)(e).
25 For example, industry sources claimed NNPC had in some cases reduced the number of unnecessary ship-to-ship transfers of imported fuel, cut out layers of middlemen on sales and improved monitoring and record-keeping at fuel supply depots. Author interviews, traders, fuel marketers, industry consultants and government officials, 2015-17. For more promised changes, see NNPC, "Press Release – NNPC Announces Measures to Sustain Products Supply Nationwide," 13 February 2017.
26 2016 DSDP contract Preamble, Art.3.2.
27 Id., Art. 9(4)(ii).

For pricing the crude oil involved, the 2016 DSDP contract makes it clear that the parties must use NNPC's monthly official selling prices.[28] This is a major improvement over the Duke RPEA, which allowed an NNPC subsidiary to set lower prices. Evidence from a PwC evaluation suggested this happened in at least some cases.[29]

Regarding fuel pricing, however, I found room for further improvements on the following points:

Changing the gasoline price benchmark. As is typical for a West African fuel import contract, the 2016 DSDP contract uses formulas to price all of the gasoline, kerosene or diesel delivered. Each formula consists of a benchmark price, published daily by an oil price reporting service, plus a set per-unit premium that the parties negotiate before signing the contract. The premiums are meant to cover some of the costs incurred by the contract holder, but also reflect the specific qualities of the particular types of product required by the Nigerian market.

Like the PPMC-Duke RPEA, the 2016 DSDP contract requires the parties to use the benchmark "FOB Barges Rotterdam" for "10 ppm premium unleaded" gasoline, published by Platts, for pricing all gasoline shipments.[30] However, I conclude that NNPC would likely get better value in the 2017 contracts from switching to Argus Media's daily Eurobob oxy barges quote for gasoline.[31] There are two main reasons for this. First, the Argus quote is the most widely used regional benchmark for gasoline sales in Europe, the origin of most of the gasoline imported under the DSDP contracts.[32] The minimum quality specifications (or "spec") for the Argus quote are also closer than the Platts spec to the quality standards required in the 2016 DSDP contract, mainly because the Argus quote covers lower octane gasoline.[33]

Second, the Argus Eurobob quote is more liquid than the Platts—and as such, may be potentially less subject to manipulation. Argus arrives at its daily number for the Eurobob quote by taking the weighted average of all relevant gasoline sales reported throughout the day.[34] Platts, by contrast, calculates its 10ppm quote based only on sales reported within a trading window that is only open for 30 minutes per day.[35] Furthermore, the 10ppm quote is not widely used outside of West Africa—mainly just in Nigeria and Ghana.[36] Altogether, this means that the sales Platts uses to calculate the 10ppm quote tend to make up only a small fraction of total gasoline imports to Nigeria. As an illustration: Platts reported 483,000 tons of sales within the window between January 2016 and February 2017. But in the same period, companies chartered tankers to carry at least 17 million tons of fuel to West

28 Id., Art.1.1. (definitions of "Benchmark," "Premium" and "Option"), Art.9.1-9.2.
29 Sayne, Gillies and Katsouris, *Inside NNPC Oil Sales*, B13-14; PwC, Investigative Forensic Audit into the Allegations of Unremitted Funds into the Federation Accounts by the NNPC, February 2015, 141
30 2011 PPMC-Duke RPEA Art.9(B); 2016 DSDP contract Art.9. Platts puts out its numbers for the 10ppm quote in its daily *European Marketscan* publication. For an example, see Platts, *European Marketscan*, Volume 48: Issue 211, 31 October 2016.
31 Argus put out the quote in its daily *Argus European Products* report. For an example, see Argus, *European Products*, Issue 15-164, 25 August 2015.
32 Author interviews, 2017. Platts remains the most widely used source of quotes for diesel and kerosene produced in Europe, however.
33 2016 DSDP Contract Annex A; c.f. Argus Media, *Argus European Products: Methodology and Specifications Guide*, last updated February 2017; Platts, *Methodology and Specifications Guide: Europe and African Refined Oil Products*, last updated March 2017.
34 Argus Media, *Argus European Products*, 10.
35 Platts, *Methodology and Specifications Guide*, 4.
36 Author interviews, traders and industry consultants, 2016-17.

Africa.[37] This relatively low liquidity raises the risk that interested parties could influence the quote significantly by buying or selling only a few thousand metric tonnes (MT) within the Platts window.

It should also be noted that the volumes traded in the Platts window for 10ppm gasoline can be extremely erratic. In 2016, for example, volumes ranged from one barge of 1,000 MT each per month up to 125 barges of 1,000 MT each per month. For three months in 2016, a total of only 15 barges were traded (February, 5 barges; July, 3 barges; December, 7 barges).[38] Where liquidity is volatile, it would be prudent to use a quote that has greater liquidity and that is the recognized benchmark for the market of supply (i.e., the European market).

There is some possibility that the Platts benchmark in the 2017 DSDP contracts could be more expensive to Nigeria over time, though further analysis would be needed to confirm this point. According to a comparison of historic data for the two quotes, the Platts 10 ppm quote was higher by an average of $12.69/MT for the period of 1 January 2014 to 15 February 2017.[39] Again, the higher octane levels in the Platts 10ppm spec is a significant cause of this. We cannot say definitively that the observed trend will continue. DSDP contract holders could also try to negotiate higher gasoline premiums if NNPC switched to a lower-priced benchmark. I do not therefore attempt here to estimate cost savings to NNPC of switching benchmarks from the Platts 10ppm to the Argus Eurobob. Nonetheless, the historic data, together with the Argus quote's higher liquidity and representativeness, make a strong case for the change.

I asked NNPC in writing how retaining Platts as the benchmark in the 2017 contracts would serve its, and the nation's, best interests, but the corporation did not reply. According to some interviewees, NNPC officials have expressed concerns in the past that refiners would stop selling gasoline into Nigeria if NNPC bought using the Argus Eurobob quote.[40] Basic market dynamics argue strongly against this, though: European refineries collectively produce far more gasoline than the continent consumes. The excess volumes have to be exported, and the main outlets for it are the Transatlantic region and West Africa—Nigeria especially. It seems unlikely that refiners would suddenly refuse to do business with one of their biggest buyers.

Finally, in the area of gasoline pricing, the 2017 DSDP term sheet contains a potentially significant change from the 2016 DSDP contract. Specifically, the sheet proposes a two-formula pricing framework, under which NNPC would "reserve the right to choose" between the Platts 10ppm quote and another Platts benchmark known as "WAF FOB NWE." Platts introduced the WAF quote in 2015 in what it described as an attempt to "bring greater transparency to the daily value of gasoline imported into West Africa."[41] The new quote tends to come in lower than the older 10ppm, again partly because it covers lower octane fuel.[42] On its face, the idea of introducing a lower octane, region-specific benchmark in the 2017 DSDP deals could seem attractive. However, industry players contacted for this briefing all thought that even fewer buyers and sellers of Nigerian-grade gasoline use the Platts

37 Historic Platts data and clean tanker fixtures data on file with NRGI. Note that it is not possible to state exactly how much of the West African tanker traffic during this period was shipments of gasoline to Nigeria. When reporting vessel charters to commercial reporting services, charterers often do not state the type of fuel the vessel will be carrying nor its precise destination in West Africa. Nonetheless, deliveries of gasoline to Nigeria are by far the largest category of fuel import to the region.

38 Pricing data on file with NRGI.

39 2014-17 Cost data on file with NRGI.

40 Author interviews, industry consultants and West African gasoline trader, 2017.

41 Platts, "Press Release – Platts Introduces New Price Assessments to Bring Transparency to West African Gasoline Market," 7 September 2015.

42 Pricing data on file with NRGI.

WAF quote than the 10ppm, meaning it could be even more easily influenced by small sales in the Platts trading window.[43] We asked NNPC about their rationale for this change but did not receive a response.

Setting gasoline price premiums on a quarterly basis. Probably the single biggest cost savings that NNPC secured in the 2016 DSDP contract came through negotiating lower premiums for gasoline. The agreement prices gasoline at $25/MT over the Platts 10ppm quote from October to March (which the contract calls "the Winter Season") and $2/MT *below* Platts from April to September ("the Summer Season"). Compare these numbers—the net discount especially—with the year-round $81.28/MT premium that the PPMC-Duke RPEA allowed Duke.[44] While I take no final position on the fairness of the 2016 premiums, in *Inside NNPC Oil Sales* we found that the 2011 Duke premium was almost certainly much too high.[45]

The two-season pricing structure in the 2016 contract also looks like an improvement, since Nigerian-grade gasoline sees predictable premium increases in winter months.[46] Going forward, NNPC could better capture seasonal shifts in the market by re-negotiating premiums with DSDP contract holders each quarter. Traders interviewed for *Inside NNPC Oil Sales* said gasoline import contracts outside Nigeria tend not to last longer than a quarter, and those that do tend to allow the parties to review prices periodically.[47]

Reducing sulfur content in DSDP imports. In December 2016, Nigeria joined four other West African nations in a pledge to cut sulfur in its gasoil (diesel) imports.[48] This followed a widely covered campaign, led by the Swiss NGO Public Eye, that accused some traders of selling dangerously high-sulfur fuels in the region.[49] Specifically, the countries agreed to revise their gasoil specs to cap sulfur in diesel imports at 50 parts per million (ppm) by July of this year.[50] NNPC, under the auspices of the African Refiners Association (ARA), has also expressed support for reducing sulfur in its imported gasoline to a maximum of 150ppm by 2020.[51]

How these commitments will play out in the 2017 DSDP contracts is far from clear, however, as multiple conflicting numbers are in circulation. For gasoline, both the 2016 DSDP contract and Nigeria's Department of Petroleum Resources' (DPR) most recent specs capped sulfur levels at 1,000 ppm. DPR has not formally issued a revised spec.[52] Confusingly, the gasoline spec attached to the 2017 DSDP term sheet called for a maximum of 150 ppm—in line with the ARA proposal—but some claim NNPC is now trying to impose a 50 ppm cap on preferred bidders.[53]

43 Author interviews with traders and industry consultants, 2017.
44 2011 PPMC-Duke RPEA Art.9(B).
45 Sayne, Gillies and Katsouris, *Inside NNPC Oil Sales*, B15-16.
46 This is mainly because Nigeria does not vary the required amount of RBP additives in its gasoline in winter, unlike European markets.
47 Sayne, Gillies and Katsouris, Inside NNPC Oil Sales, B18.
48 United Nations Environmental Program (UNEP), "Press Release – West African Countries Adopt Low Sulfur Diesel Standards," 1 December 2010.
49 Public Eye, *Dirty Diesel – How Swiss Traders Flood Africa with Toxic Fuels* (Public Eye, 2016). Public Eye's investigation focused less on Nigeria than on other countries in the sub-region.
50 UNEP-Nigerian Federal Ministry of the Environment, "Communique Ministerial on Promoting Low Sulfur Fuels in Nigeria and Neighboring Countries," 1 December 2016.
51 "African refiners move on specs after criticism," *Argus Media*, 14 March 2017. This is in line with the model "AFRI-4" fuel quality standards promoted by the ARA and World Bank following a 2009 study of African refining practices. See ICF International, *Final Report –Sub-Saharan African Refinery Project* (World Bank-ARA, 2009).
52 2016 DSDP Contract Annex A; DPR, Specification for Premium Motor Spirit on file with NRGI.
53 Libby George and Alexis Akwagyiram, "West African push to clean up toxic fuel hits snags," Reuters, 2 February 2017; author interviews, traders and NNPC official, 2017.

The situation for gasoil is similarly confused. The 2017 DSDP term sheet's gasoil spec kept sulfur levels at 500 ppm—seemingly at odds with the government's pledge to reduce to 50 ppm. The most recent DPR spec for gasoil allows up to 5,000 ppm.[54]

If companies do not know the grades of fuel they will have to supply under the 2017 DSDP contracts, that could complicate negotiations. It could also delay the signing of final deals, though NNPC has not confirmed this.[55] Nigeria's resolve to cut sulfur in the fuel its citizens use is a positive development, given how the mineral can harm air quality and respiratory health. But it would be unfortunate if confusion over new quality specs led to unreasonable hikes in fuel price premiums. Already some traders and industry consultants are arguing that stricter sulfur rules could add USD 10-20/MT to the cost of DSDP gasoline imports.[56]

Since most of the gasoline imported under the 2016 DSDP contracts came from Europe, where sulfur standards are already generally tight, switching to a 150 ppm, or even 50 ppm spec may not greatly affect currently available supplies. [57] Before agreeing to much higher premiums, NNPC officials should at a minimum review the quality inspection reports from cargoes of gasoline imported under the DSDP so far, to see how much sulfur was in the fuel contract holders were willing to supply at 2016's lower prices.

I asked NNPC officials about the corporation's plans for changing sulfur standards in the 2017 contracts but did not receive a response.

Clarifying which bill of lading the parties must use to calculate prices. A fuel cargo's bill of lading (B/L) is a document accompanying the cargo that confirms how much fuel has been loaded aboard the ship, states some key terms of delivery, and confirms who has title to the fuel. Multiple sources interviewed for *Inside NNPC Oil Sales* claimed that some companies supplying fuel to NNPC in the past falsified the date on a given cargo's B/L, or substituted one B/L for another, in order to charge NNPC a higher price. This is possible because the fuel was priced using an average of published Platts quotations, and the cargo's B/L date determines which quotes to use. By shifting the date to a period when quotes were higher, some companies allegedly could overcharge NNPC by as much as hundreds of thousands of dollars for a cargo.[58]

The 2016 DSDP contract carries similar risks, though I found no clear cases of misconduct. The contract provides that the date on each refined product cargo's B/L is what determines which five Platts quotes should be averaged to fix the price benchmark for the cargo.[59] Delivering fuel to NNPC under the DSDP deals often involves multiple vessels, which can result in the creation of multiple B/Ls for a single delivery. Each of these B/Ls can have different dates, sometimes weeks or even months apart.[60] Unfortunately, the 2016 contract does not state which of them the parties should use when figuring product prices. Industry sources told us that NNPC typically uses the B/L issued when the contract holder first picks up the

54 2017 DSDP term sheet, appendix; DPR, Specification for Automotive Gas Oil on file with NRGI; author interviews, traders and industry consultants, 2017.

55 Christina Katsouris, "Nigeria Delays Awarding Crude-Swap Contracts," *International Oil Daily*, 16 March 2017; author interviews, traders and Nigerian government officials, 2017.

56 George and Akwagyiram, "West African push;" Katsouris, "Nigeria Delays;" author interviews with traders, 2017.

57 It could however force blenders of Nigerian-grade gasoline to use different, sometimes more-expensive components in the blending process.

58 Author interviews, trading company personnel, industry consultants, EFCC, NNPC and PPPRA officials, 2012-2015.

59 2016 DSDP contract Art. 9.3.

60 For more detail on the supply chain, see Sayne, Gillies and Katsouris, *Inside NNPC Oil Sales,* B18-19.

fuel at the loading port.[61] If this is correct, there is no obvious reason why the DSDP contracts should not state this explicitly as a rule.

Including a gasoil spec. On a final note, the 2016 DSDP contract does not include a minimum quality spec for deliveries of gasoil. Quality is one of the main variables in pricing fuel. As such, the reasonableness of the gasoil pricing formula in the contract is hard to assess without reference to a spec.

2. Choice of parties

NNPC has not publicly explained how it will choose winners from among the 128 firms that submitted bids for DSDP contracts this year. The invitation to tender it released in January contained some minimum criteria,[62] and called on companies to attach more supporting documentation to their bids than in prior rounds. Some of this material—annual reports, tax certificates, corporate filings and the like—could help NNPC judge the companies' industry bona fides, assuming officials had the time to sift through it. But it would not tell them much about the integrity of bidders' business practices, or the risks of doing business with them from an anticorruption perspective. I find two main areas of concern:

Continued use of intermediaries. Like the old RPEAs, NNPC's DSDP contracts have not required the winners to refine any of the crude they receive. The corporation did pick seven companies that own refineries for the first round of deals,[63] but the 2016 DSDP contract gives them free rein to sell their allocations of oil and use the proceeds to buy fuel from other suppliers for delivery to NNPC. For 2017's deals, the corporation has said it will take bids from a range of contestants, including foreign refiners or fuel retailers, international fuel trading companies "with established Nigerian presence," and local companies "engaged in Nigerian oil and gas downstream activities with petroleum product trading expertise."[64]

At first glance, this would seem to undermine earlier promises by management to "eliminate" the presence and associated costs of middlemen in Nigeria's oil-for-fuel transactions.[65] Past NRGI research documented the corporation's history of selling oil to inexperienced intermediary companies, sometimes as a tool of political patronage.[66] Almost none of the companies that held swaps during the Jonathan era were obvious choices based on their qualifications.[67] Several developed serious reputational or legal troubles problems during or shortly after the deals ended.[68] The presence of well-connected middlemen has also raised corruption risks and perceptions in NNPC's broader oil sales system. In a recent NRGI blog post I argued

61 Author interviews, traders and industry consultants, 2015 and 2017.

62 For example, winners must be able to show "minimum turnover of $500 million (or the naira equivalent) and net worth $250 million (or the naira equivalent) for the Financial Year Ending of 2015 [sic.]." They must also submit data on their gasoline trading activities over the past four years. NNPC, Invitation to Tender for a Direct Sale of Crude Oil and A Direct Purchase of Product (DSDP), January 2017, 3.

63 Libby George and Julia Payne, "Cash-strapped Nigeria turns to oil swaps to stave off gasoline shortages," *Reuters*, 18 March 2016.

64 NNPC, Invitation to Tender, 1.

65 NNPC, "Press Release – NNPC Replaces Offshore Processing Arrangement," 3 October 2015; NNPC, "Direct-Sale Direct-Purchase to Replace Crude Swaps, Takes off March – Kachikwu," 2 February 2016.

66 Sayne, Gillies and Katsouris, *Inside NNPC Oil Sales*, 45-49.

67 Id., B8-9.

68 Three of the companies, for example, were implicated in Nigeria's $6.8 billion fuel subsidy scandal. A government committee ultimately cleared two of fraud, though not of other alleged abuses of the subsidy scheme. Federal Government of Nigeria, Presidential Committee on Verification and Reconciliation of Fuel Subsidy Payments, final report, 2012, 12; Nigerian Presidency, Report of the Technical Committee on Payment of Fuel Subsidies, June 2012, 69, 74. A Nigerian court sentenced two of the third company's principals to prison for subsidy fraud in 2017. Ben Ezeamalu, "Subsidy fraudsters sentenced to 10 years in prison," *Premium Times*, 26 January 26 2017.

that the higher number of inexperienced local firms holding crude oil export contracts this year raises concerns that patronage will grow.[69]

These serious concerns noted, it would be reductive to assume that only DSDP deals signed with refiners would perform well for Nigeria. Experienced traders have arbitrage, hedging and logistical skills that refiners may lack; some will have better access to low-cost supplies of Nigerian-grade fuel. Indeed, forcing contract holders to refine all of the oil they receive may not always be the most cost-effective option for either side—especially since the 2016 DSDP contract does not give the refiner the right to demand particular grades of crude at particular times.[70] Market data analyzed for this report suggested that 2016 DSDP contract holders traded much of the crude they received.[71]

It is important to be precise about the risks posed by allowing intermediaries to manage barter deals such as the DSDP. Allowing contract holders to trade the crude they receive is not inherently problematic, as long as NNPC—and by extension, Nigeria—are allowed to share fairly in the upsides of that. Problems arise more when intermediaries are chosen for political or patronage reasons, as has been common in the past. The key is being clear about how allocation decisions are made.

To boost efficiency and minimize corruption risks in its DSDP contracts, NNPC should seek to sign with companies that have easy access to affordable Nigerian grade gasoline; crude trading experience; logistical competence; financial stability and evidence of ethical business practices. Most of 2016's winners measured up decently in these areas. Several, for example, are established, reputable European refiners with their own ample supplies of gasoline. Yet others are not known for processing, blending or trading large amounts of Nigerian-grade fuel; a couple have stakes in only small refineries in geographically suboptimal places, which consequently could raise freight costs to Nigeria. One international trading company had an interest in three out of seven contracts worth 150,000 b/d (or 45 percent of total contracted DSDP volumes) via partly-owned subsidiaries.[72] Because NNPC did not publicly explain why it chose 2016's winners, the rationales behind such choices are hard to understand.

Requirement of indigenous participation. NNPC has made considerable room for local companies in the DSDP program. The 2016 DSDP contract has three parties: NNPC, a foreign refiner and a "local partner" for the refiner. The 2017 invitation to tender similarly requires foreign bidders to have local partners, and seems to leave open the possibility that a Nigerian company could win a contract without a foreign partner. Management has said that "grow[ing] indigenous

69 Aaron Sayne, "Nigeria's 2017 Oil Sale Contract List Shows New Names, Old Tendencies," NRGI, 23 January 2017.

70 The ability to access preferred grades of crude oil is often critical for refiners. Refining economics are complex: the business tends to generate tight margins, and plants usually are not technically configured or positioned in the market to refine any grade at any time for a net profit.

71 2016 lifting reports and tanker traffic data on file with NRGI.

72 Author interviews, traders, refiners, Nigerian government officials and industry consultants, 2016-17; corporate documents on file with NRGI.

capacity" is a major goal of the DSDP program.[73] Nigeria's local content law puts some pressure on the corporation to do business with Nigerian firms.[74]

Under the right circumstances, requiring more indigenous participation on DSDP deals to local companies could be good policy. However, the 2016 DSDP contract was not drafted in ways that would actively promote capacity transfer between the parties. Most notably, the contract does not split roles or responsibilities between the refiner and local partner. Instead, it assigns obligations to both of them interchangeably and orders them to agree who will do what in a separate subcontract.[75] According to industry sources, the roles played by the 2016 local partners have varied widely between contracts. On some of the deals, they said, the foreign refiners have leaned heavily on the Nigerian companies to handle logistics and government interface, while others have done most of the work themselves.[76] Nor does the 2016 contract include other provisions requiring the foreign refiners to share knowledge, skills or technology with their partners, all of which could help build domestic capacity.

I have not personally seen evidence of questionable practices by local partners relating to the 2016 DSDP contracts. Recent investigative reporting by *Premium Times* found that one of the partners had sold approximately 40 million liters of NNPC-owned gasoline that was stored at the partner's fuel depot in Lagos without informing NNPC. The partner denied any wrongdoing, and Premium Times said it had confirmed that the partner eventually "replaced the 40 million litres which has since been sold at various stations by the NNPC." An NNPC spokesman said the corporation was investigating the matter.[77]

There is no reason to suppose that Nigerian companies are inherently less able than foreign firms to manage a DSDP deal with skill and integrity. But without well-articulated goals, targets or modalities for building local capacity, and given the corruption risks that arose in the past, requiring indigenous participation could become one of the biggest areas of questionable cost and risk in the deals. Interviewees believed that the local companies party to the 2016 DSDP contracts have been earning an average of $5/MT on all products delivered.[78] (NNPC did not respond to a request to confirm this figure.) Given that the 2017 contracts will bring in several million MT of fuel to Nigeria over the course of a year, Nigerian companies in the deals collectively could be entitled to tens of millions of dollars if the refiner-local partner model continues.

Officials in the Jonathan government also justified making room for indigenous companies in the swaps as necessary to boost their skills.[79] That arguably happened in a few cases. But after making margins on billions of dollars of oil and fuel, most

73 NNPC, "Press Release," 2 February 2016.

74 How far existing law ties NNPC's hands should not be overstated, however. The most relevant provision, Article 3.1 of the 2010 Nigeria Oil and Gas Content Development Act, states only that "Nigerian independent operators shall be given first consideration in the award of [...] oil lifting licenses and in all projects for which contract [sic.] is to be awarded in the Nigerian oil and gas industry." Nowhere does the act impose quotas, minimum percentages or similar measures for government contracts like the DSDP. For instance, a schedule attached to the act showing minimum targets for different types of licenses, contracts and services does not include figures for oil or fuel sale contracts. Arguably, NNPC could award no DSDP contracts to local companies and still be in compliance with the act, so long as it gave locals "first consideration" (a term which the act does not define).

75 2016 DSDP contract Art.25.3, 28.1. Also, according to the definitions section, all mentions of the "Company" in the contract refer to both/either of the refiner and partner. Id., Art 1.1.

76 Author interviews, traders, government officials and industry consultants, 2016-17.

77 "EXCLUSIVE: Capital Oil, NNPC officials in fresh 90 million litres petrol scandal," *Premium Times*, 15 March 2017.

78 *Ibid.*

79 "Alison-Madueke explains award of crude oil lifting contract to indigenous firms," *Vanguard*, 28 April 2014.

of those local companies have now been replaced, and have seen their business with NNPC dwindle under the new administration. Some have faced serious legal and reputational trouble since their contracts ended.[80] It would be unfortunate if the current roster of local companies associated with the DSDP deals faced similar controversy in future.

NNPC officials did not respond to my inquiry about NNPC's role in selecting the local companies that win DSDP contracts, and its understanding of what the companies' roles and responsibilities should be.

3. Allocation of crude oil grades and volumes

As noted above, NNPC's DSDP contracts do not promise holders particular grades of crude oil, or give them rights to demand certain grades. Instead, they include per-day estimates of the oil NNPC will supply—either 30,000 or 60,000 b/d in the 2016 contracts—and a list of twelve export grades that the corporation can choose from.[81] This is similar to how NNPC allocates crude under its standard oil-for-cash term lifting contracts. The corporation also has a history of awarding contracts for more oil than it will likely have to sell. Earlier this year, it signed 39 term lifting contracts for a whopping 1.31 million b/d, at a time when its published data for January-October 2016 shows total government oil sales, under both the term contracts and the DSDP, averaged only around 600,000 b/d.[82]

In *Inside NNPC Oil Sales*, we noted how under past contracts this open-ended system created a monthly bottleneck in which traders jockeyed to receive particular grades and volumes from key officials—a scenario that comes with high corruption risks.[83] NNPC has not publicly explained how it manages this kind of competition. One top official told us during research for a previous NRGI publication that NNPC will roll out "a predictable allocation framework so that [...] associated corruption risks are eliminated."[84]

CONCLUSION AND RECOMMENDATIONS

NNPC has jettisoned many of the worst features of the costly oil-for-product swaps of the Jonathan era in its first round of DSDP deals. Management put in place a more professional contract that is more balanced and less susceptible to abuse. The improved terms and management of the 2016 contracts are among the most concrete signs of improved oil sector governance under President Muhammadu Buhari. Overall we hope the recommendations that follow will stimulate greater discussion and oversight of these important deals, and look forward to engaging constructively in this conversation. To build on the gains of 2016, NNPC officials could consider the following additional, important reforms:

80 After a change in government, Nigeria's anti-corruption police opened investigations of some of the swap deals; most of the companies publicly denied wrongdoing. Julia Payne, "Nigeria starts investigating crude oil swap contracts," Reuters, June 13, 2015. No charges directly related to the swaps have been filed to date, though in 2016 Nigerian anti-corruption police declared the managing director (MD) of another of the companies wanted on suspicion of "criminal conspiracy, diversion of funds and money laundering" in another oil-related bribery scheme. The MD replied that he was "a law-abiding citizen" and had not failed to honor any summons from the police. Eniola Akinkuotu, "N23bn Diezani bribe – EFCC declares billionaire businessman wanted," *Punch*, 16 August 2016. Another of the companies has faced multiple suits from creditors over allegedly unpaid debts relating to its swap deal. "Once-favoured Taleveras struggles to keep afloat," *Africa Energy Intelligence*, 28 February 2017.

81 2016 DSDP contract Art.3.1.

82 NNPC, *Monthly Financial and Operations Report*, November 2016.

83 Sayne, Gillies and Katsouris, *Inside NNPC Oil Sales*, 52.

84 Aaron Sayne, "Nigeria's 2017 Oil Sale Contract List."

Pricing

- Adopt the Argus Eurobob oxy benchmark for pricing gasoline delivered under the 2017 contracts.
- Consider setting gasoline price premiums on a quarterly basis to better reflect seasonal shifts in relevant gasoline markets.
- Review the sulfur levels listed in quality inspection reports for 2016 DSDP gasoline imports before raising 2017 gasoline price premiums because of changes to the sulfur spec.
- Insert language into the 2017 contracts stipulating that the parties must use the date on the bill of lading issued at the loading port for purposes of pricing all cargoes of gasoline, kerosene and gasoil.
- Include a quality specification for gasoil.
- Publish a summary of key terms for the 2017 DSDP contracts.
- Commit to publishing future commodity sales contracts, including all DSDP contracts.

Choice of parties

- Publish the full legal names of winning bidders for the 2017 DSDP contracts.
- Publicly explain how and why they chose the particular DSDP contract holders for 2017.
- Publicly explain how requiring indigenous participation in the contracts will increase Nigerian capacity in oil and fuel sales, and the modalities for ensuring this happens.
- Consider including a description of respective roles and responsibilities for the different parties to the 2017 contracts, especially for any three-party contracts signed to advance local capacity, rather than allowing the contract holders to work out details in separate subcontracts.
- Develop stronger anticorruption due diligence systems for vetting bidders as part of the selection process.
- Commit to collecting and disclosing beneficial ownership data in future DSDP and other contract awards.

Allocation of crude oil

- Publicly explain the process for allocating oil among new contract holders.
- Publish per-cargo oil sales data on a regular basis in 2017, to show which contract holders are receiving oil.

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