Proposal to Commence Negotiation

For

Tripartite Crude Handling Agreement with TOTAL E & P NIGERIA LIMITED for Obagi field Injection

August 2016

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Security Classification:	Confidential	ECCN classification:	No US Content

Business Unit or Company	The Shell Petroleum Development Company of Nigeria Ltd. ("SPDC")
Group equity interest	100% in SPDC; 30% in SPDC Joint Venture ("SPDC JV")
Other partners	SPDC JV partners: Nigerian National Petroleum Corporation ("NNPC") (55%) Total E & P Nigeria Ltd. ("TEPNG") (10%) Nigerian Agip Oil Company Ltd. ("NAOC") (5%)
Business or Function	Upstream International Operated, Nigeria (Commercial)
Potential third parties	Total E&P Nigeria Ltd.(TEPNG): Operator of NNPC/TEPNG JV NNPC (60%), TEPNG (40%).
Project	Description: Renewal of Crude Handling Agreement (CHA) between SPDC JV and TEPNG JV. Headline Size: $40.9 million Shell share ($136.3 million – 100%) of projected revenues (MOD) on a daily injected average volume of 28,000bbls at 330 operational days/year for 2016 – 2020, on an average starting tariff of $3.00/bbl.
Project objectives and expected deliverables	Objective: Continued provision of crude handling services for TEPNG Obagi field injection and secure improved commercial & operational framework on CHA renewal. Deliverable: Executed CHA by Q3 2016
Secure Mandate via PCN **Review Draft CHA and Share with TEPNG** **Negotiate and Execute CHA**	August 2016 December 2015 Q3, 2016
Timescales	The current CHA commenced in 2010 for a five year duration and was therefore stated to expire in 2015 but has been extended by parties till June 30, 2016 to accommodate renewal negotiations.

Summary Economics / Business Impact	• The CHA for production from OML 58 will be renewed as requested by TEPNG, but in the Tripartite CHA format. • SPDC has re-determined the base 2016 opex tariff derivable from either a three-year average annual operating cost basis or from end 2015 operating cost baseline • In addition to the annual tariff review based on the US CPI index, SPDC will explore the opportunity of updating the capital tariff to reflect recent capital expenditure on SPDC facilities. • The economic evaluation for TEPNG PCN was done on a forward-look Basis. This project required no Capex investment to gain the revenues, hence non-applicability of VIR. The PCN base case assumed a proposed tariff of US$2.95/bbl and OPEX from Production Charges. The results show that at the proposed tariff the project will be valuable. The evaluation also considered sensitivities around a decrease and increase in the variable opex and at two other ullage capacities. The team needs to be proactive on opex increases as the results indicate a loss position if the Opex rises above 25%.

		Sensitivities			
Case	Base Case	Prod. +25%	Prod. -15%	Opex +25%	Opex -15%
NPV0 US$ (Mln)	1.3	1.7	1.1	-0.1	2.1
NPV7 US$ (Mln)	1.1	1.4	0.9	-0.1	1.8
VIR	NA	NA	NA	NA	NA
Proposed Tariff USD/bbl	3.0	3.0	3.0	3.0	3.0
Opex US$ (Mln)	36.4	42.1	31.1	45.8	31.1

Section 1: The Proposal (Management Summary)

This PCN seeks management approval to commence negotiations with TEPNG for Obagi field (OML58) Crude handling Agreement (CHA) renewal under modified terms and conditions.

SPDC and ELF (now Total – TEPNG) signed a Crude Handling Agreement in 1981 for handling and processing of TEPNG's OML 58 crude at a tariff of $0.50/bbl. The current OML 58 Crude Handling Agreement dated 11 November 2013 between the SPDC JV and the TEPNG JV commenced in 2010 with a five year duration and was stated to expire in 2015 but this has been extended by parties till June 30, 2016 to enable continued service provision during the renewal negotiations.

The renewal negotiations were stalled due to the crude theft methodology disputes which involved DPR acting as an arbiter. In December 2015, the DPR made a suite of recommendations stating that:

a. SPDC should stop the use of its current crude theft methodology of 70% theft and 30% measurement inaccuracy and commence use of a new crude theft methodology of 38% theft and 62% measurement inaccuracy.
b. SPDC to pay back crude theft volume (724,883bbls) to Chevron, WalterSmith and NDPR
c. TEPNG to make a refund of 2,476,000 bbls to the SPDC JV as opposed to the SPDC calculation of 6.5million bbls being owed by TEPNG for crude theft backlog repayment from 2002 - 2013.

After several engagements involving TEPNG, SPDC, DPR and NAPIMS, it was agreed on the 13th of May 2016 that SPDC will continue to provide crude handling services on the same terms as the expired CHA up to June 30th 2016 to allow parties to negotiate a new CHA. It was also agreed that TEPNG will commence a monthly payback of 160kbarrels for all the crude theft volume debt owed by TEPNG JV to SPDC JV from 2002-2013 and SPDC will implement, in the interim, the DPR theft/loss sharing formula (38% Theft and 62% Measurement Inaccuracy) until the DPR review of the crude theft formula submitted by SPDC is concluded.

Background Information

Over the period March 2010 to December 2015, SPDC JV has handled about 43,926,452 bbls from Obagi. The cumulative invoice payment from March 2010 to December 2015 is about F$ 96,964,114.46 mln. For the period in view (2010 – 2015), the CHA has seen a decline in its start-up reserved production capacity (RPC) from 40Mbpd to 28Mbpd.

Section 2: Value Proposition and Strategic Context

Value Proposition

The key benefits to be derived from this proposal are:

- SPDC will earn revenue (ullage fees/tariffs) for utilization of spare ullage capacity on the Trans Niger Pipeline (TNP) and within the BOGT terminal network.
- Improved relationship with Government (NNPC/DPR) as continued provision of the crude handling service demonstrates support to Federal Government's drive to optimally utilise the capacity of the JV facilities in Oil/Gas Production
- Implement the interim crude theft loss handling process as communicated by DPR, until the SPDC proposed new methodology is approved by DPR.

Strategic Context

The Crude Handling business in Nigeria is guided by procedures issued by NAPIMS (Procedure for Determination of Crude Ullage Fees) and DPR (Procedure Guide for The Determination of the Quantity and Quality of Crude Oil and Petroleum Products at Custody Transfer Points). The applicable tariffs are based on the principle of cost-recovery for the ullage service.

Tariff Review & Analysis

The tariff charges are distinguished into terminal/pipeline capex and terminal/pipeline opex. The capex charges are calculated based on Reserved Production Capacity (split between percent crude and water). Over the 5year period of the existing agreement with TEPNG, the terminal capex charge has increased to $1.13/bbl while the pipeline capex has increased to $0.61/bbl. This is in line with the escalation terms as stated in the CHA, based on US Bureau of Labour Price Index, published yearly.

	Unit	Current Tariff on existing CHA	Cost/bbl
Terminal - Dry Crude	**per % RPC crude**	**$1. 13**	**0.83**
Terminal - Opex	**Per Injected Volume**	**$0. 48**	**0.57**
Terminal – Water	**per % RPC water**	**$1. 15**	
Pipeline - Capex	**per RPC**	**$0.61**	**0.37**
Pipeline - Opex	**per Injected Volume**	**$0. 32**	**0.64**
TOTAL(existing CHA)		**$ 2.54**	**2.41**

Shell Share RT16

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Obagi field

The CHA allows for annual re-determination of the OPEX charges premised on SPDC's actual operating costs per barrel. SPDC expects that more value will be salvaged through re-determination of the OPEX tariff derivable from end 2015 baseline tariff.

Section 3: **Risks, Mitigation Measures and Alternatives**

Risks & Issues	Managing & Mitigation Action
Disputes on Crude Theft Allocation Methodology: DPR disputes SPDC 70/30 methodology for crude theft / measurement inaccuracy. Proposed a new split 38/62.	SPDC's proposed methodology has been shared with DPR and is currently going through reviews. The intention is for DPR to adopt the methodology and issue as the loss allocation methodology for the Industry. DPR may not accept the entire methodology but it is believed that a methodology with DPR's backing will forestall disagreements on crude theft deductions in the industry therefore SPDC is willing to continue to engage DPR to ensure any methodology issued has inputs from SPDC as an operator of the facilities. In the interim, SPDC will use the DPR proposed methodology for calculating crude theft/measurement inaccuracy for all injectors into the Bonny Terminal.
Metering: a. Functionality of installed LACT units b. Crude quality c. Over-estimation of injection during breakdown of crude metering and sampling equipment.	1. Carry out an Integrity Assurance of installed LACT unit prior to renewal of this CHA 2. Verify compliance to scheduled meter proving & calibration 3. Ensure appropriate isolation and fencing of LACT unit premises and that access is only open to the parties at the same time. 4. Ensure adequate sampling is taken and at regular intervals, to monitor the crude quality at the LACT

	units prior to injection in addition to online BS&W measurements. 5. Ensure availability of robust measurement back-up with scheduled timelines for maintenance and repair. Implement a BS&W uplift to cover for period of temporary breakdown of metering equipment.
Chemical contamination and injection of off-spec crude: Contamination of Bonny light due to use of unapproved additives during operations, or injection of off-spec crude by Operator of OML 58.	The CHA will include a provision that makes operator of OML 58 liable for any and all damage arising from injecting contaminated or off-spec crude/additives into the pipelines and terminal. SPDC will also retain the right to request immediate suspension of injection from OML 58, until the quality of crude is verifiably restored.
Non-payment of 2002 – 2010 crude theft allocation TEPNG has consistently delayed the payback of crude theft volume owed to SPDC JV.	Issue resolved with TEPNG and DPR. TEPNG has commenced payment of 160,000barrels per month on the 2002 – 2010 Crude Theft volume backlog. Payment schedule to be continuously monitored.
Value loss due to inconsistency with BOT Crude API TEPNG crude injection is a commingled stream of processed raw crude mixed with its mini (topping) refinery residue and there is the potential for this to impact the BOT API	In addition to the requirement for TEPNG to submit its crude assay on biannual basis, SPDC will also collect samples and analyse the TEPNG commingled crude stream on biannual basis. SPDC will also retain the right to curtail/suspend TEPNG crude injections if the API level falls outside of the BOT acceptable band.
FOREX exposure Third party injectors generally prefers to pay for crude handling services in NGN (some have relied on the CBN circular of 17th April 2015 which directed that pricing of goods and services in Nigeria should be in NGN).	The CBN clarification letter of 21st May 2015 exempts Oil and Gas operations and services from their directive in their letter of 17th April 2015, and it states clearly that Operators in Oil and Gas include Oil Service Companies are allowed to make and receive payments in foreign currencies. Crude handling services to TEPNG will be billed at a minimum of 40% in USD.
Non-payment of crude handling fees:	TEPNG have a good payment record therefore the decision was taken not to include the requirement for a Letter of Credit which is part of the Tripartite CHA model. However the CHA still preserves SPDC's right to retain crude volumes in cases of default of payment. Also if default is in excess of 90 days, SPDC will have the right to demand TEPNG nominates a vessel to lift and sell the crude volumes retained, and instruct the party lifting the crude to deduct the amount due from the sale proceeds and remit same to SPDC. This is in addition to the right to refuse to accept SHIPPER CRUDE and/or suspend transportation of COMMINGLED CRUDE until any outstanding payment is made.

Section 4: **Negotiation Strategy**

This negotiation is focused on the renewal of the contract for crude handling services in the new format of a tripartite model Crude Handling Agreement. This involves the roles of Pipeline Operator and Terminal Operator being recognised separately even though both roles are currently being managed by SPDC.

Section 5: **Corporate Structure and Governance**

This opportunity will be negotiated and governed by SPDC on behalf of the SPDC-JV in line with the Joint Operating Agreement.

Section 6: **Functional Support and consistency with Group Standards**

Functional support will be provided by Economics, Legal, Finance, Hydrocarbon Allocation and Pipelines teams to ensure alignment with Group Standards.

Section 7: **Project Management, Monitoring and Review**
Decisions relating to the CHA will be subject to the GM Commercial and NOV (Peter Whyte) as Decision Executive (DE); The Business Opportunity Manager is the Commercial Manager, Crude Handling (Ralph Gbobo). The "core" negotiation team will be led by Olufemi Ajayi, with Legal support from Boma Odu.

Section 8: **Budget Provision**
This opportunity is anticipated to be a zero CAPEX project. Any additional request for improved monitoring (new meters, not required for SPDC business) will be borne by TEPNG. The operating cost for staff time and logistics will be met from SPDC JV 2016 budget provisions through normal operations of own facilities

Section 9: **Group Financial Reporting Impact**
Group Financial Reporting Impact not required at this time.

Section 10: **Disclosure**
This opportunity will not require disclosure of material confidential information. However, Group and SPDC disclosure management requirements will govern any public announcements.

Section 11: **Financing**
Not relevant, no capital investments are associated with this project.

Section 12: **Taxation**
There are no unusual Taxation features.

Section 13: **Key Parameters**
This proposal seeks the mandate to negotiate a CHA with TEPNG as follows:
Term: 5 Years
Initial Reserved Production Capacity (RPC):28kbbl/d
Total Tariff Charge: US$ 3.76/bbl. Max. (40% NGN and 60% USD Min.)
Headline Size: $40.9 million Shell share ($136.3 million – 100%) of projected revenue

Section 14: **Signatures**

Initiated by:

…………………………………
Peter Whyte
(UIO/G/CN, GM Commercial & NOV)
Date: ….. /……/ …..

Supported by:

………………………………

Guy Janssens
PJA SEPA-FUP/OG; FM Nigeria & Gabon
Date: …../…../…..

Consented to:

……………………………..

Markus Droll
SEPA-UPO/G; VP Nigeria & Gabon
Date: …../…../…..

Appendix 1 – TEPNG Revenue Projections (2016 – 2020)

Obagi

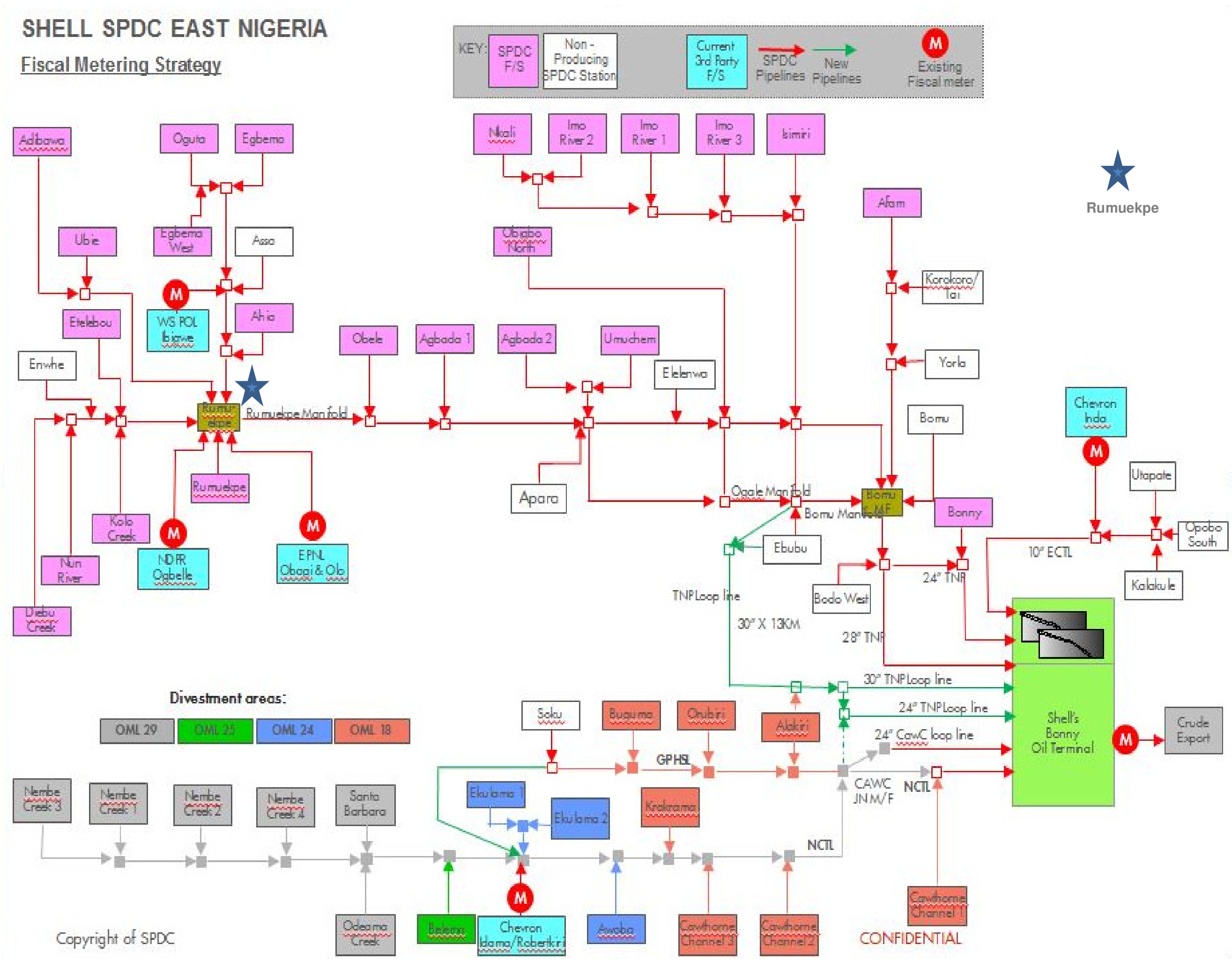
Year	Unit	2016	2017	2018	2019	2020
Capex Tariff	Per bbl	2.95	2.95	2.95	2.95	2.95
Volume (RPC Average)	Unit	28,000	28,000	28,000	28,000	28,000
Daily Revenue	F $'000	82,600	82,600	82,600	82,600	82,600
Operational Days/Year	Days	330	330	330	330	330
Annual Revenue	F $mln	27,258,000	27,258,000	27,258,000	27,258,000	27,258,000
5 year Summary						
Revenue from CHA	136.3	mln USD				
Shell Share (30%)	40.9	mln USD				

Appendix 2:

Functional Support for this PCN was obtained from the following:-

Function	Name	Title	Signature	Date
Legal	Barbara Blum	AGC – Nigeria & Gabon	By Email	8th July, 2016
Commercial Operations	Peter Whyte	GM, Commercial & NOV	By Email	20th July 2016
Shipping	Richard Hibbert	Corporate Shipping & Export Manager - SPDC	By Email	8th August, 2016
Treasury	Claudia Kroeger	Treasurer – UP & PT	By Email	17th August 2016
Tax	Dapo Otunla	Country Tax Lead - Nigeria	By Email	24th August 2016
Controller	Jonathan Anolu	Controller, Nigeria	By Email	
Finance	Guy Janssens	FM, Nigeria & Gabon	By Email	

Appendix 3:



SHELL SPDC EAST NIGERIA
Fiscal Metering Strategy
KEY:
SPDC F/S
Non - Producing SPDC Station
Current 3rd Party F/S
SPDC Pipelines
New Pipelines
Existing Fiscal meter
Rumuekpe
Adibawa
Oguta
Egbema
Ubie
Egbema West
Assa
WS POL Ibigwe
Ahia
Etelebou
Enwhe
Rumuekpe Manifold
Kolo Creek
Nun River
Diebu Creek
NDPR Ogbelle
EPNL Obagi & Obi
Obele
Agbada 1
Agbada 2
Umuchem
Elelenwa
Apara
Nkali
Imo River 2
Imo River 1
Imo River 3
Isimiri
Obigbo North
Afam
Korokoro/ Tai
Yorla
Bomu
Ogale Manifold
Bomu Manifold
Bomu MF
Bonny
Ebubu
Bodo West
TNP Loop line
30" X 13KM
24" TNP
28" TNP
10" ECTL
Chevron Inda
Utapate
Opobo South
Kalakule
30" TNP Loop line
24" TNP Loop line
24" CawC loop line
Shell's Bonny Oil Terminal
Crude Export
Divestment areas:
OML 29
OML 25
OML 24
OML 18
Soku
Buguma
Orubiri
Alakiri
GPHSL
CAWC JNM/F
NCTL
Nembe Creek 3
Nembe Creek 1
Nembe Creek 2
Nembe Creek 4
Santa Barbara
Ekulama 1
Ekulama 2
Krakrama
Odeama Creek
Belema
Chevron Idama/Robertkiri
Awoba
Cawthorne Channel 3
Cawthorne Channel 2
Cawthorne Channel 1
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