OPL245 Brief

1 Refresh on the Project

SNUD has PSC 2000 with NNPC. $540mln committed to OPL245, $210 signature bonus (in escrow and by now ~$235mln) and $330mln development activity. Economics below are forward looking under and $330mln development activity. Economics below are forward looking under current fiscal terms.

Shell economics (BP10 – slightly different to March PCN) put a NPV7 value of $0.8bln ($60 oil price) with VIR of 0.18 on 100% contractor rights.

Block value at $80 is $3.2bln ($1.9bln contractor and $1.3bln concessionaire). Contractor VIR is 0.41.

SNUD has drilled four exploration wells. Discovered volumes amount to 458 MMboe (Etan/Zabazaba prospect).

Zabazaba and Etan development projects are currently in the pre-DG2 phase; FID for the Zabazaba development is assumed for August 2016. Zabazaba Phase 1 is an 18-well sub-sea development producing to a 120kbopd FPSO (leased) with 1st oil in 2021 with development Capex of US$ 6.2bln (MOD, excludes FPSO lease costs of $2.7bln) to develop 326 MMbbls. Subsequent sub-sea tie backs from Etan is a 10-well sub-sea development producing to the Zabazaba host assuming 1st oil in 2024 with development Capex of some US$4.4bln (MOD) to develop 133 MMbbls.

In absence of gas PSC terms no gas value is included in the economics above, although gas evacuation costs are included.

Exploration prospects in OPL 245 amount to udSFR of 540MMboe (e.g. Songu, Zabazaba NW) - the value related to these prospects have not been included in the economic evaluation.

Under the PSC signed by SNUD in 2003, the OPL expires on 22 December 2013, the OPL work programme has been fulfilled and conversion to OML will require 50% of the area of the OPL to be relinquished.

2 FGN View of 245

In 2006 as settlement of disputes between FGN and Malabu, FGN (re)awarded OPL245 to Malabu conditional on a signature bonus of $210mln being paid. Payment never made.

In June 2010, Attorney General wrote to Malabu confirming allocation to Malabu and giving explicit control of the Block to Malabu. Whereas the 2006 letter was silent in many areas, the 2010 AG letter explicitly deals with rights to operate and sell all rights, including contractor rights.

This letter was followed by a similar letter from MOP to Malabu awarding the reaffirming the 2006 position of FGN provided the signature bonus was paid within 90 days (from July 3 2010).

We are told, but have not seen the letter, that the 90 day period referred to above has been extended to somewhere upward of 9 months.

The AG has told Mutiu that "Shell made a clear mistake by putting signature bonus into escrow, thereby recognizing a dispute over ownership existed"

The AG has written a "full brief on 245" for the President.

The MOP has requested the regulator (DPR) to issue the license to Malabu.

There is no evidence that since the departure of Adjumegobia as Minister of State, any part of Government either cares about, or comprehends, the BIT issue.

The sentiment in Abuja has moved against Shell in the last 12-24 months from;

- (Lukman) - Etete should get nothing - but not going to take any action; to
- (Ajomegobia) - post amnesty need to support Etete so 50:50 split is only way forward; to
- (Diezani/AG/President) - Etete owns the block 100%, and taking action consistent with this.

3 March 2010 PCN

In March 2010 a PCN was submitted and approved in which Shell would negotiate a settlement as follows:

- 50:50 split between Etete and Shell;
- Malabu to pay 50% of past costs to Shell ($270mln).

As a consequence, Shell would forgo 50% contractor rights and gain 50% equity rights. The economics associated with this (updated to BP10 numbers) at $60 ($80 values in brackets) was:

- NPV of $1.1bln ($1.9bln) of which $0.8bln ($1.6bln) was block value and $0.27bln was recovery in cash of 50% past costs;
- Project VIR 0.48 (0.85).

4 Arbitration Background/Status

- On 26th April 2007 filed a request for arbitration with ICSID which was accepted on 16th May 2007;
- On 30 April 2009 SNUD filed its Statement of Claim and FRN filed its counter memorial on 25th August 2009;
- On 22nd October 2009, SNUD filed a further reply with Expert reports, witness statements and legal opinion and FRN responded likewise on 17th December 2009;
- From 29th - 31st of March 2010, the hearing on the merits took place in Paris;
- On 17th and 19th of May 2010 SNUD and FRN respectively filed their post hearing briefs;

- Arbitral panel expected to formally order closure of proceedings and award expected latest by end Q4 2010 but it could be issued shortly after both parties have paid the further requested instalment for the arbitration costs (due this Friday but deliberately delayed by SNUD to buy a little more time)

The case presentation from our external counsel and witnesses went very well and the demeanor of the panel showed a keen appreciation of the issues at stake. It is usually a difficult task to say with any measure of certainty what the outcome of a legal proceeding will be. There is a high probability of a ruling in favour of SNUD but the terms of such ruling are uncertain. The options being:

(i) a reinstatement of title;
(ii) loss of title but award of full compensation claimed;
(iii) loss of title but award of partial compensation claimed; or
(iv) loss of title but award of past cost and reimbursement of signature bonus.

5 OML130 (OPL246) Benchmark

At the same time as Malabu was awarded OPL245, Danjuma (Northern General) was awarded OPL246. In 2006 Danjuma entered into a SPA with CNNOC. Whilst the structure of this block is somewhat complicated in essence:

- CNOOC paid $1.75bln to purchase 45% contractor (to NNPC) interest in OML130;
- Danjuma maintained 5% contractor rights and a concessionaire position;
  - At financial close CNNOC paid an additional ~$0.9bln as their share of past development expenditure;
  - In doing so, they acquired an interest in a block under development 2 years prior to first oil.

Based on the above, indicatively the CNOOC purchase valued contractor rights at $3.9bln and total block at $7.9bln. Combining equity retained (with a carry) and cash received, Danjuma has value from the block of circa $2.3bln.

6 ENI Involvement

Etete has appointed a broker to sell his interest in the Block. Initially, we believed that they were looking at Russian interests as the buyer. In March 2010 (at the time of PCN discussion) we had indications that ENI were in some way becoming involved.

ENI have a confidentiality agreement with the Broker and are constrained in talking directly to either Etete or Shell (according to ENI).

We are told by ENI that the trigger for their interest in 245 was a request from Berlusconi which in turn was a result of a Russia/Italy government to government engagement.

This suggests (but we have no firm confirmation) that 245 may be part of something beyond simply buying into a deepwater Nigerian block.

7 Possible Dispute Resolution

7.1 No Deal – Arbitration Finalized

The decision by the Arbitration Panel is imminent, following the final hearing in March/ April 2010. This is Treaty based expropriation arbitration between SNUD and FGN. We believe we will be successful (70% POS), which results in a cash award in favor of SNUD, payable by/enforceable against the FGN. Although SNUD's primary demand is for confirmation that the PSC with NNPC stands, it is not likely arbitrators would want to grant such relief.

A reasonable estimate of the "floor" for an award is ~$500mln (Signature Bonus & Past Costs) with a maximum possible award of $1.5bln (submitted value of lost income from expropriation of the Block).

It is reasonable to assume that as a minimum the return of escrow monies ($209mln + interest – circa $240mln) would be done as part of payment of award.

As such, a reasonable base case for arbitration decision being made is award of $500mln or more, of which $240mln is recovered from escrow, and the remaining amount has a low POS of being recovered directly from FGN - depending also on SNUD's willingness to enforce the same against FGN assets abroad.

7.2 ENI/Malabu deal – Disputes settled post BIT award

It is possible that a resolution to 245 is achievable after an arbitration award is delivered. If an award is granted to SNUD the amount of that award may become the new baseline for any new settlement as any third party (ENI/Malabu) will take it as the new starting point not the NNPC/SNUD PSC.

In a post arbitration award settlement, the Shell position at best will be one of negotiating a position in 245 based on compensation for the award against FGN.

This will happen against the backdrop of the block being seen as unencumbered and owned by Etete.

Our position would be a function of:

- The award outcome and size of award;
- FGN attitude to award (incentive to settle or ignore);
- The impact of settlement post versus pre-election;
- ENI approach to continuing transaction in cooperation with Shell and the value attributed to a "receivable" payable by FGN.

A reasonable working assumption is that any award converted to equity through negotiation would see Shell secure 10-30% in the block.

7.3 ENI/Malabu Deal – Disputes amicably settled prior to election and award

ENI is committed to step into the block, buy out Malabu and enter into an agreement with Shell to equally (50/50) share the license and its economic benefits (concessionaire + contractor rights).

In discussions with ENI, they have approached the issues on finding a settlement as:

$$X + SB + Y = Z$$

Where:

- X is value that ENI prepared to pay to secure 50% of the Block;
- SB is Signature Bonus to be payable to FGN (by Shell);
- Y is any amount that Shell is prepared to pay to supplement the amount paid by ENI to Etete and thus "ensure" success;
- Z is payment to Etete that will be acceptable to all players in Abuja;

ENI, following data room visit have stated that they are prepared to pay $ 800mln (X) to acquire 50% interest in 245.

ENI has proposed for Shell to contribute the Signature Bonus and another $165mln (Y) for an ENI irrevocable offer to Malabu of $1.2bln (Z). The figure of $1.2bln to Etete is considered the minimum figure acceptable in Abuja.

Following payment of the signature bonus (paid from escrow direct to FGN) net revenue to Malabu is $1bln.

ENI's rationale behind this "disproportional contribution" (ENI 2/3 Shell 1/3) is to compensate Shell for the additional fiscal benefits the block would get from FGN (tax waivers, stability provision on 2000 PSC terms, no NNPC back in rights) following settlement with Shell to terminate arbitration.

ENI offered that they could increase X if change of operatorship would be agreed.

The deed of assignment date from DPR to ENI and Shell would be the new OPL start date (10 + 20 years).

7.3.1 ENI Economics (Details and sensitivities in Attachment 2)

Using Shell base case economics (no gas rights, no exploration upside, BP10), with ENI paying $0.8bln ($1bln payment in brackets) for 50% of the block and assuming $80 oil price:

- ENI NPV is $0.8bln ($0.6bln);
- VIR is 0.27 (0.19)

7.3.2 Shell Position (thus far)

The key issues in negotiation are:

- What is the minimum price to Etete that gets a deal;
- What is the maximum price ENI is prepared to pay for 50% of the block;
- How do we recover (in some way) past costs.

The ambit claim emanating from Abuja is that the price to Etete is $2bln. This we believed is based on OPL246 benchmark. However, in the lead up to elections, we believe that a figure in the range of $1-1.2bln will be accepted.

We believe that the $0.8bln offered thus far by ENI is a start point. They have already indicated they are prepared to pay an additional $100mln for operator rights. ENI moving from $0.8bln to $1bln, together with Signature bonus (from Shell) is likely to put us in "deal space" with no Shell cash contribution (Y). Shell position is that no additional monies will be paid to secure settlement.

Thus far Shell has been silent on cost recovery – being an issue to be discussed as part of Shell/ENI JOA negotiations. Repayment options are:

- Cash at settlement - $165mln;
- Recover at First oil – NPV $65mln (no cash);
- Tax recovery only – NPV 45mln (no cash).

8 Strategy Going Forward

Shell is silent currently on past cost recovery more aggressive than recovery at first oil.

There are 2 key variables that need to be tested:

- ENI walk away price (X);
- Etete/Abuja pre-election "MASP" (Z).

We believe that whilst positioning any offer in Abuja as non-negotiable it is (almost) inevitable that a negotiation of some kind will ensue.

The respective positions can be summarized using X + SB + Y = Z as:

Today	800 (x) + 210 (SB) + 0 = $1.0bln (Z)
Deal Space - ENI Aim	800 (x) + 210 (SB) +160 (Y) = $1.2bln (Z)
Deal Space - Shell Aim	1000 (x) + 210 (SB) + 0 (Y) = $1.2bln (Z)
Etete	2000 (x) = Z

As such, position is to maintain that Shell contribution over signature bonus is $0. That a settlement proposal is made to Etete based on ENI payment + Signature bonus alone. ENI then forced to make assessment of whether they add more to increase likelihood that Etete accepts. Once offer is made it will clearly test Abuja appetite for short term cash.

At this point we expect renewed pressure on Shell to add cash.

Attachment 1 (Economics of Settlement Options for Shell)

A Shell - NNPC PSC

		$/bbl	50	60	80
	100% Licence Holder NPV7		538	791	1292
Shell old situation	100% Contractor NPV7		225	827	1946
	Contractor VIR7		*0.05*	*0.18*	*0.41*
	Capex PV7		4455	4455	4455

B PCN

		$/bbl	50	60	80
	50% Contractor NPV7		113	414	973
	50% Licence Holder NPV7		269	395	646
	50% Signature Bonus & Past Costs		270	270	270
	50% Capex PV7		2228	2228	2228
Shell new situation	Shell NPV7		651	1079	1889
	Shell VIR7		*0.29*	*0.48*	*0.85*

C ENI - Shell PSA

		$/bbl	50	60	80
	50% Contractor NPV7		113	414	973
	50% Licence Holder NPV7		269	395	646
	50% Capex PV7		2228	2228	2228
C.1 without re-payment of past cost & SB					
Shell new situation	Shell NPV7		381	809	1619
	Shell VIR7		*0.17*	*0.36*	*0.73*
ENI new situation	ENI NPV7		381	809	1619
	ENI VIR7		*0.17*	*0.36*	*0.73*
	50% Past Costs		165	165	165
C.2 with re-payment of past cost only (now):					
Shell new situation	Shell NPV7		546	974	1784
	Shell VIR7		*0.25*	*0.44*	*0.80*
ENI new situation	ENI NPV7		216	644	1454
	ENI VIR7		*0.10*	*0.29*	*0.65*
	50% Past Costs, discounted 10 years		69	69	69
C.3 with re-payment of past cost only (at FOD):					
Shell new situation	Shell NPV7		450	878	1688
	Shell VIR7		*0.20*	*0.39*	*0.76*
ENI new situation	ENI NPV7		313	740	1551
	ENI VIR7		*0.14*	*0.33*	*0.70*
	50% Tax benefit of Past Costs		45	45	45
C.4 with full tax benefit of past cost only to Shell:					
Shell new situation	Shell NPV7		426	854	1664
	Shell VIR7		*0.19*	*0.38*	*0.75*
ENI new situation	ENI NPV7		337	764	1575
	ENI VIR7		*0.15*	*0.34*	*0.71*

FOD assumed in 10 years

Attachment 2: ENI Economics

Zabazaba & Etan							
Base Case				Oil Price ($RT10/bbl)			
				50	60	80	100
50% Contractor NPV7			mln$RT10	113	414	973	1,509
50% Licence Holder NPV7			mln$RT10	269	395	646	887
50% Capex PV7			mln$RT10	2,228	2,228	2,228	2,228
Consideration paid by ENI (mln$)	0	ENI NPV7	mln$RT10	381	809	1,619	2,396
		ENI VIR7	-	*0.17*	*0.36*	*0.73*	*1.08*
	800	ENI NPV7	mln$RT10	-419	9	819	1,596
		ENI VIR7	-	*-0.14*	*0.00*	*0.27*	*0.53*
	1,000	ENI NPV7	mln$RT10	-619	-191	619	1,396
		ENI VIR7	-	*-0.19*	*-0.06*	*0.19*	*0.43*
	1,200	ENI NPV7	mln$RT10	-819	-391	419	1,196
		ENI VIR7	-	*-0.24*	*-0.11*	*0.12*	*0.35*

Zabazaba & Etan							
At $80/bbl				Sensitivities			
				Base Case	20% less cost	20% more production	acceleration 3 years
50% Contractor NPV7			mln$RT10	973	1,216	1,386	1,182
50% Licence Holder NPV7			mln$RT10	646	709	858	775
50% Capex PV7			mln$RT10	2,228	1,850	2,228	2,628
Consideration paid by ENI (mln$)	0	ENI NPV7	mln$RT10	1,619	1,925	2,244	1,957
		ENI VIR7	-	*0.73*	*1.04*	*1.01*	*0.74*
	800	ENI NPV7	mln$RT10	819	1,125	1,444	1,157
		ENI VIR7	-	*0.27*	*0.42*	*0.48*	*0.34*
	1,000	ENI NPV7	mln$RT10	619	925	1,244	957
		ENI VIR7	-	*0.19*	*0.32*	*0.39*	*0.26*
	1,200	ENI NPV7	mln$RT10	419	725	1,044	757
		ENI VIR7	-	*0.12*	*0.24*	*0.30*	*0.20*