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Nigeria Oil and Gas: Marginal Fields

In November 2013, Nigeria's Department of Petroleum Resources (DPR) announced the 2013 Marginal Fields Licensing Round, which has captured the interest of the international oil and gas community. This article examines the legal framework relating to marginal fields in Nigeria, as well as issues to consider when investing in marginal fields.

What is a marginal field?

A marginal field is a field located within an area covered by an existing oil mining lease (OML) held by one or more companies, which:

- has oil and gas reserves booked and reported annually to the DPR;
- has remained unproduced for 10 years; and
- is declared to be a marginal field by the President.

Marginal fields may also have some, or all, of the following features:

- oil reserves with unconventional crude oil characteristics (such as very high viscosity and low API gravity);
- high gas and low oil reserves; and
- they may have been abandoned by the OML holder for upwards of three years.

Unproduced discoveries in open blocks are not eligible to be declared marginal fields, as they form part of the whole acreage that may be awarded in new OML licensing rounds.

The DPR held Nigeria's first marginal field licensing round in 2002, in an effort to:

- encourage participation by indigenous oil companies[1] in the Nigerian oil and gas industry; and
- limit the continuous holding of undeveloped fields by international oil companies (IOCs), thereby increasing the Government's take from such fields.

The legal framework

Nigeria first codified its policy on the acquisition of marginal fields by oil companies through an amendment to the Petroleum Act 1969 in 1996. The Act is supplemented by the Guidelines for Farm-out and Operation of Marginal Fields 2013 (2013 Guidelines). These guidelines replaced the earlier 2001 guidelines.

Grant of rights to marginal fields

The DPR carries out the allocation of marginal fields in accordance with a process akin to a licensing round, outlined in the relevant guidelines (currently the 2013 Guidelines) at such times as determined by the Minister of Petroleum Resources.

Currently, the process requires that the marginal fields on offer are publicly announced and that eligible companies are invited to submit to the DPR proposals which satisfy the requirements of the relevant guidelines. The DPR will pre-select up to five companies per marginal field on offer.

Pre-qualified companies will then be invited to submit a field-specific technical and commercial bid. The bid will be based on field data made available by the holder of the OML and/or the DPR. Successful applicants will be duly notified by the DPR following consideration of bids.

Upon selection, the successful bidders are required to enter into negotiations with the OML holder(s) regarding the terms of a farm-out agreement (FA) in relation to the marginal field. It is the FA that permits the successful bidder to carry out exploration and production operations in the marginal field.

In addition to the process instigated by the Government, the holder of an OML may also (with the consent of the President) initiate a farm-out of a marginal field which lies within its leased area.

[1] An indigenous oil company is defined in the DPR's Marginal Fields Guidelines as one which is "substantially Nigerian" and registered solely for the purposes of an exploration and production business.

Nature of rights to a marginal field

It is important to understand that under the marginal fields regime, the rights of the successful bidder to carry out exploration and production activities arise under the FA entered into with the holder of the relevant OML. That is, a successful bidder "wins" the right to enter into an FA, rather than being granted a separate title by the Government. Moreover, the marginal field will continue to form part of the original lease area of the relevant OML. Under the FA, the marginal field is contractually ring-fenced from the remainder of the lease area for the relevant OML, but the company carrying out operations in the marginal field (the farmee) will not, ultimately, gain a joint interest in the OML with the other holders of the OML (the farmors).

This Government-sanctioned and statue-based farm-out regime raises some important questions for potential investors about the nature of the title granted to a company in relation to a marginal field.

An analogy has been drawn with a lease and sub-lease structure. Under this analysis, the Government (as the lessor) grants a lease to the OML holder(s), who (as the lessee) enters into a sub-lease with the marginal field holder in relation to the marginal field (as sub-lessee). Thus, by implication, the OML holder(s) is the legal owner of the marginal field, rather than the farmee.

This interpretation is supported by a number of provisions under the 2013 Guidelines, which contemplate that:

- the marginal field holder will have to pay an overriding royalty to the OML holder(s) in relation to production from the marginal field; and
- the OML holder(s) have a reversionary interest in the marginal field, so that if the FA is terminated or expires, the marginal field shall revert back to the OML holder(s).

However, going against this interpretation, the 2013 Guidelines also provide that:

- once the FA is entered into, the farmee "shall have all the rights of an OML holder in respect of the farm-out area containing the field(s) and all the "rights interests and duties of the previous leaseholder shall be transferred to the new leaseholder";
- the farmee will have the right and obligation to deal directly with the DPR and other administrative authorities "as the leaseholder"; and
- all rights and liabilities of the farmor in respect of the farm-out area containing the field will automatically transfer to the farmee and the farmor will be relieved from those rights and liabilities, from the date of execution of the FA.

It seems that the regime contemplates that the farmee will acquire a title capable of enforcement independently of the OML. However, questions remain as to the exact nature of the rights granted to farmees, and in particular, to what extent those rights could be undermined if, for example, the relevant OML was revoked.

Key features of a farm-out agreement

The 2013 Guidelines envisage that the FA will contain provisions dealing with the following matters:

- Obligation to the Government – the farmee will be responsible for the payment of all applicable fees and bonuses payable in relation to the marginal field, and for the procurement of Government approval for the FA, which shall be a condition precedent to the effectiveness of the FA.
- Field Data – the farmors are required to "lease" to the farmee previous data acquired in respect of the marginal field.
- Assignment – the farmee will not be permitted to assign its rights under the FA without the prior approval of the Minister of Petroleum Resources. The consent of the farmors is also likely to be required.
- Indemnity – the farmee may be required to indemnify the farmors against liabilities, including environmental and decommissioning liabilities, arising from the farmee's activities within the marginal field. This may include an obligation to provide security.
- Decommissioning – the farmee may be required to provide security to cover the costs of decommissioning of the marginal field.
- Unitisation – the conclusion of a unitisation agreement may be a condition precedent to the FA where the marginal field covers reservoirs which straddle other licensed areas.
- Government back-in rights – the operations of the farmee will be subject to the Government's right to back-in (that is, acquire a participating interest) to the marginal field.

The farmee and the farmor are required to agree the consideration payable to the farmor for the farm-out of the marginal field. The farmor and the farmee are also required to agree other matters, such as overriding royalties to be paid to the farmor, as well as the terms of a crude handling and transportation arrangement (including the tariff payable to the

farmor, which may take the form of a right to take a percentage of the farmee's production). Where the parties are unable to agree, the Minister of Petroleum Resources will adjudicate in the dispute.

Role for IOCs in marginal fields?

As only indigenous oil companies are considered eligible to apply for and/or operate marginal fields, local marginal field operators are entitled to enter into joint venture partnerships with IOCs to meet the initial high capital costs of hydrocarbon exploration, subject to a maximum ultimate equity participation of 40 per cent.

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