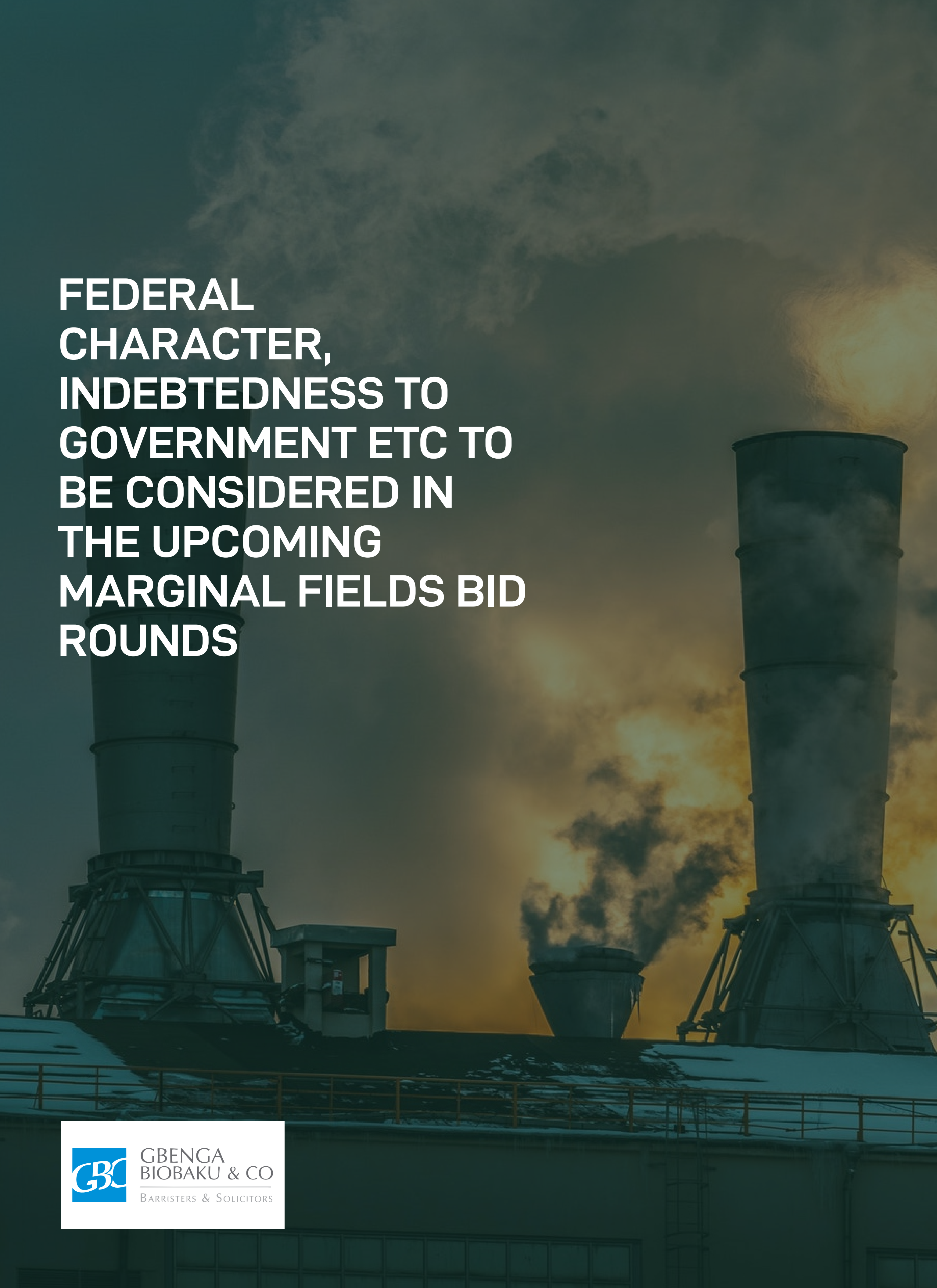

FEDERAL CHARACTER, INDEBTEDNESS TO GOVERNMENT ETC TO BE CONSIDERED IN THE UPCOMING MARGINAL FIELDS BID ROUNDS

GBENGA BIOBAKU & CO
BARRISTERS & SOLICITORS

Introduction

The Department of Petroleum Resources ("DPR") on the 1st of June 2020, announced the commencement of the 2020 Marginal Field Bid Round for indigenous companies and investors interested in participating in Nigeria's exploration and production sector.

Bid Round

The bid round is aimed at growing production capacity through diversification of resources and inflow of investments, increasing oil and gas reserves base through aggressive exploration, boosting indigenous participation and employment opportunities in the sector, and reducing production cost.

Marginal Field

The 2020 Marginal Field Guidelines ("Guidelines") recently released defines a Marginal Field as "any field that has (oil and gas) reserves booked and reported annually to the DPR and has remained un-produced for a period of over 10 years". Operating Companies are required to carry out field studies, update their portfolio of undeveloped fields and report status to the DPR on a periodic basis. All fields that could be classified as "Marginal" shall be presented and agreed to by DPR.

Un-produced oil and gas discoveries in open blocks are however, not qualified for farm-out as such blocks form part of the whole acreage which would be awarded in new license rounds so as to encourage new frontier explorations. The DPR has also indicated that oil fields under litigation will not form part of the fields offered by the federal government under the proposed bid round.

> Un-produced oil and gas discoveries in open blocks are however, not qualified for farm-out as such blocks form part of the whole acreage which would be awarded in new license rounds...

Applicable Fees

According to the DPR, applicable fees per field are N500,000 for registration; N2m for application; N3m for bid processing; $15,000 for data prying; $25,000 for data leasing; $50,000 for competent persons' report, and $25,000 for field-specific report.

Eligibility of Bidders

Overall, the process is open to all indigenous companies that are "wholly or substantially" Nigerian, duly registered to carry out exploration and production operations in Nigeria, and can demonstrate requisite experience and capabilities to develop the field. Applicants will be evaluated on the basis of proof of corporate existence and credible organization, evidence of technical and managerial capability, solid financial ability (including capability to pay the signature bonus upon award of a field), demonstrated Nigerian content and commitment to community development. The Company must be an indigenous company and must also demonstrate Federal Character representativeness.

Also noteworthy is that where Companies or their promoters are indebted to the Government or currently have assets that are not being operated in a business-like manner, they will not be pre-qualified by DPR. It is not clear what the basis of indebtedness would be in this case. One might expect to see that outstanding payment obligations, such as in taxes or other fiscal obligations, penalties, or indebtedness arising from compromise arrangements or other financial understandings (bona fide or otherwise) entered into with government agencies etc would be relevant here.

Notwithstanding, the DPR is not under any obligation to pre-qualify any submitted bid application. The Guidelines further prescribe that not more than five companies should be pre-qualified per field and no company will be pre-qualified for more than three (3) fields.

Time Line

The expected timeframe for the completion of the marginal field bid round process would be in December 2020 which is six months from the date of announcement to contract signing with the leaseholders.

The 2020 Marginal Field Guidelines ("Guidelines") recently released defines a Marginal Field as "any field that has (oil and gas) reserves booked and reported annually to the DPR and has remained un-produced for a period of over 10 years". Operating Companies are required to carry out field studies, update their portfolio of undeveloped fields and report status to the DPR on a periodic basis. All fields that could be classified as "Marginal" shall be presented and agreed to by DPR.

Quoted from: Marginal Field on page 2

Overall, the process is open to all indigenous companies that are "wholly or substantially" Nigerian, duly registered to carry out exploration and production operations in Nigeria, and can demonstrate requisite experience and capabilities to develop the field.

Quoted from Eligibility of Bidders on Page 3

Considerations for Bid Participants and Investors

Federal Character:

The concept of "federal character" was captured under Nigeria's 1999 Constitution in order to address the issue of bias in government against any specific tribe, as follows:

"...the government of the Federation or any of its agencies and the conduct of its affairs shall be carried out in such a manner as to reflect the federal character of Nigeria and the need to promote national unity and also to command national loyalty, thereby ensuring that there shall be no predominance of persons from a few states or from a few ethnic or other sectional groups in that government or in any of its agencies."

While it is clear from the above that the Constitution seeks to ensure that at the government level, no one tribe is favoured above another, it is uncertain how this would apply in terms of eligibility for a Marginal Field bidder. The closest credible analogy would be that the government intends to see that the shareholding of bidders reflects equity participation of Nigerians originating from different regions. Yet this may not be so straightforward where the shareholders of the bidding entity are not natural persons, but corporate entities.

Applicants will be evaluated on the basis of proof of corporate existence and credible organization, evidence of technical and managerial capability, solid financial ability (including capability to pay the signature bonus upon award of a field), demonstrated Nigerian content and commitment to community development.

Quoted from: Eligibility of Bidders on page 3

Legal status of Marginal Fields

The holder of a marginal field does not appear to have a direct interest in the OML; instead it obtains a contractual interest by virtue of the farm-out agreement, which is akin to a sub-lease from the OML holders. This raises questions about the validity of the marginal field interest where the OML expires or is revoked and the legal position of the marginal field holder under the Petroleum Act. This situation can also prove tricky for conventional lending structures.

Develop or Lose

The Guidelines appear to set an effective five year term for the award of the marginal field, and require progress in the development of the field to be shown before then (failing which the farm-out agreement can be made "void" or not be renewed). Failure could either mean their bid is unsuccessful or, if it is successful, their licence may be terminated for lack of development, with the loss of their investment made in bidding for and winning the licence.

The DPR had previously warned the owners of undeveloped marginal fields that if they do not proceed to develop the fields within a set period, they risk losing them. Earlier this year, the DPR revoked 11 marginal fields. This sends a clear message to current bidders that they need to have a clear development plan and the finances necessary to develop the fields they are bidding for.

Basis of Operation

An awardee of a Marginal Field is required to operate the same on a sole risk basis. However, it is also stated in the Guidelines that Government reserves the right to a participating interest at any time.

That said, the Petroleum Act would appear to suggest that the government's rights to back into a an oil field relates to an oil prospecting license or an oil mining lease, and can only be exercised on grounds of public interest, upon terms mutually agreed with the licensee or lessee.

The Petroleum does not make any express provision on the right of government to back into a Marginal Field. The legal force of the Guidelines vis a vis the Petroleum Act is also yet to be decided upon by a court of superior record in Nigeria.

The holder of a marginal field does not appear to have a direct interest in the OML; instead it obtains a contractual interest by virtue of the farm-out agreement, which is akin to a sub-lease from the OML holders.

Quoted from: Legal status of Marginal Fields **on page 4**

Conclusion

The commencement of the marginal field bid round is most welcome at this time where the global landscape is currently in need of low cost crude oil given prevailing global economic circumstances. The Guidelines issued by the DPR is an attempt to outline the entire process of the award of marginal fields and set out general standards and conditions expected of every bidder, applicant or awardee. Obtaining expert legal guidance very early in the process would prove highly rewarding to prospective bidders and investors in understanding the legal underpinnings of the marginal field regime in Nigeria, optimizing their bid profiling and ensuring a compliant operational strategy.

Contact Details

For more information, please contact:

Sandra Gini
Senior Associate
sandragini@gbc-law.com

Tobiloba George
Associate
tobilobageorge@gbc-law.com

GBENGA BIOBAKU & CO.
Barristers and Solicitors
11 BabafemiOsoba Crescent,
Off Admiralty Road,
Lekki Phase1, Lagos
+234 1 2717769
+234 1 2707320 (Fax)
info@gbc-law.com
http://www.gbc-law.com

Disclaimer