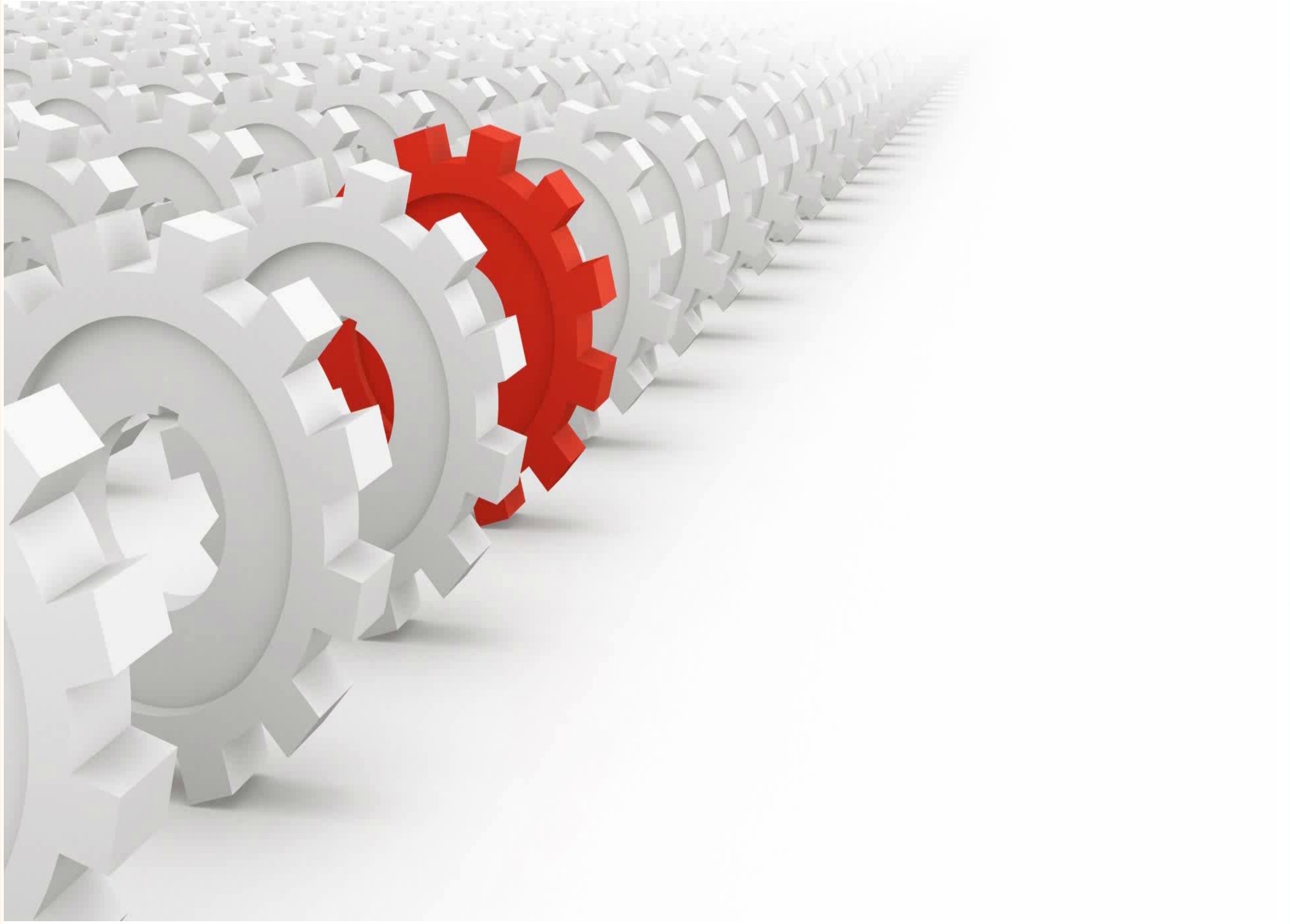

Understanding the Types of Upstream Petroleum Contracts in Nigeria

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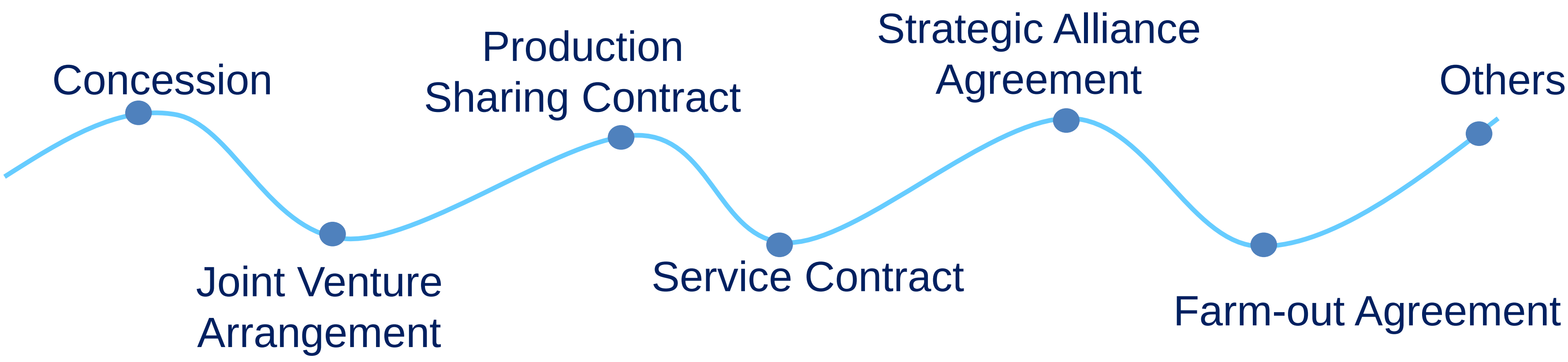
TYPES OF CONTRACTS

The Nigerian government has entered into different forms of contractual arrangements with International Oil Companies (IOCs) and indigenous oil companies for the operation of the upstream petroleum sector over time.

These include :



TYPES OF CONTRACTS

Concession

This is a government grant of privilege whereby a country transfers the right to extract minerals to an investor, typically foreign, upon certain agreed terms.

This was the earliest form of contractual arrangement in the Nigerian oil and gas industry and was in operation between 1908 to 1967.

The grant to the concessionaire was usually an exclusive right to exploit mineral resources with minimum administrative and regulatory requirements. The concessionaire determined marketing and pricing.

First concession was in 1908 to a German bitumen company who unsuccessfully prospected for oil in the Lagos Protectorate. Other concessions followed in 1937, to the duo of Shell D'Arcy Petroleum Company and British Petroleum.

The arrangement was abandoned with the advent of the Petroleum Act in 1969 which introduced three separate grants, Oil Exploration License (OEL), Oil Production License (OPL) and Oil Mining License (OML) as opposed to the single grant under concession arrangements.

OEL, OPL and OML now known as Petroleum Exploration License (PEL), Petroleum Production License (PPL) and Petroleum Mining License (PML) under the Petroleum Industry Act, 2021

Joint Venture Arrangement

- An agreement between the Nigerian National Petroleum Corporation (NNPC) and one or more oil companies to share the funding of an operation based on equity share.

- Under this arrangement, both NNPC and the Oil Company contribute to funding oil operations in the proportion of their JV equity holdings, and generally receive crude oil produced in the same ratio. JVs predominantly cover operations in the on-shore Niger Delta, coastal offshore areas and lately in the deepwaters.

- Defined by Participation Agreement and Joint Operation Agreement and synchronized by a Memorandum of Understanding.

- One of the JV partners is designated the operator.

Joint Venture Arrangement (cont'd)

Participation Agreement

- Sets out the level of participation required of every party to the JV.
- First Participation Agreement was in 1973 when the Federal Government acquired 35% shares in IOCs. By the time the sixth Participation Agreement was signed in 1993, government's interest had increased to 55%.
- Specific matters set out in a participation agreement include proportion of each party's interest in the license and assets, amount of consideration paid to the IOC by the government and prerequisite to sign a JOA upon implementation.

Joint Operation Agreement (JOA)

- A JOA governs the parties' administrative and financial relations.
- It contains the basic understanding of the JV and sets the guidelines and modalities for running the JV operations.
- JOAs were signed with the major oil producers in 1991.

Memorandum of Understanding

- The commercial terms for the JV are governed by a Memorandum of Understanding which provides fiscal incentives for the oil companies.

Joint Venture Arrangement (cont'd)

- In recent times, the FGN has been reluctant to enter into JVAs due mainly to the inability of the NNPC to fund its share of JVA costs, usually referred to as cash calls. As at 3 January 2022, the FGN's cash call liability was to the tune of $1.14 Billion.

- Tax liabilities under the JVA are separate.

- There are about 58 out of the 111 OMLs being operated under JVAs. According to the 2018 DPR (UPRC) Oil and Gas Report, JVA arrangements account for approximately 48% of the aggregate crude oil and condensates reserves.

Production Sharing Contract

- A Production Sharing Contract (PSC) is an agreement between an IOC and NNPC, authorizing the IOC to conduct petroleum operations within a specified area known as the contract area, in accordance with the particular rules of the contract. The concession is held by NNPC.

- The basic concept of a PSC is that based on a negotiated and agreed upon fiscal scheme in the PSC, the IOC recovers the costs of its investment and then the IOC and NNPC share the production of profit that remains, either after costs have been recovered or contemporaneously.

- It is used as a vehicle for achieving deep offshore production and increasing Nigeria's crude oil reserves. No financial burden on the government as the IOC fully bears the risks and expenses of operations costs at production.

Production Sharing Contract (cont'd)

- The first PSC was between NNPC and Ashland Oil Nigeria Company in 1973.
  - In 1998 , NNPC entered into PSCs with 8 IOCs.
  - In 2000 , 8 new deep water licenses were offered.
  - In 2005, 14 deep water licenses were offered
- There are 25 out of the 111 OMLs operating under the PSC regime.

Service Contract

- A contractual arrangement where the government or a license engages a company with the desired technical know-how to render services to it.

Government Service Contract (Risk Service Contract)

- For a government service contract, concession ownership remains entirely with the NNPC, and the contractor has no title to the oil produced.
- The contractor typically takes the risk of exploration, development and production and is paid a fixed fee for its services of extracting oil. In other arrangements (pure service), the contractor is paid a fee for service provided whether or not there is commercial success.

Service Contract (cont'd)

- It is a variant of the PSC save that the duration is shorter - typically 2 or 3 years and renewable for a period of 2 years.
- The Contractor has the first option to buy back the crude oil produced from the concession.
- There has been only one out of the 111 OMLs, operating under the government Service Contract regime – The OML service contract with Eni (AENR).

Service Contract (cont'd)

License Holder Service Contract

- A license holder service contract is one between an operator and an individual or a company covering routine types of work on a lease.
- Can also be referred to as non-production contracts.
- The work is usually performed with the service company's equipment and under the direction of its foreman or supervisor e.g. building roads, clearing locations, coring, drill-stem testing, acidizing, perforating and essentially all other operations on the lease except the actual drilling of the wells.
- Examples of oil servicing firms – Saipem, Field Offshore Design Engineering, Amosco etc.

Strategic Alliance Agreement (SAA)

- This is used to appoint a third-party contractor to provide technical and funding expertise to the Nigerian Petroleum Development Corporation in exchange for a percentage take in NPDC's production oil share.
- Like with a PSC, losses for the operations are borne solely by the third-party, who is entitled to recover cost and share in profit oil where operations are successful.
- The agreement is typically stated to commence upon the payment of an entry fee by the third-party.
- An example is the now terminated SAA with Atlantic Energy.

Farm-Out Agreement

- An agreement entered into by the owner of one or more mineral leases, called the "farmor", and another company who wishes to obtain a percentage of ownership of that lease or leases in exchange for providing services, called the "farmee”.
- Done for “marginal fields” - any field that has been discovered and has been left unattended for a period of at least 7 years, from the date of first discovery or anyone so-called by the President. – – Section 94 of the PIA. It was 10 years under the old regime.
- The farmee gets the right to all reservoirs within the farm-out area and the plugging of all abandoned wells drilled in the farm-out area on the farmee.
- For a well to be deemed abandoned, there must be a manifest intent to abandon and a physical relinquishment or cessation of production from the well.
- It will not be deemed abandoned if it is used for a different purpose. – Osborn III v. Anadarko Petroleum Corp – Supreme Court of Wyoming (conversion of oil well from water extraction to water injection is not abandonment).

Conversion Contracts

- Under the PIA, holders of existing OPLs or OMLs have an option to convert them into a PPL or PML through a Conversion Contract.
- Conversion allows the holder to benefit from the fiscal incentives under the PIA regime.
- Conversion will terminate all unconcluded court and arbitration cases; guarantees and stabilization clauses provided by NNPC including capital allowance on investments enjoyed for gas production.
- Upon conversion, the OML holders will be required to relinquish up to 60% of their existing acreage.
- The conversions shall become concluded or effective at the earlier of expiry dates of the current licenses or 18 months from the effective date of the PIA which is February 2023.
- Where OPL or OML holders choose not to convert to the PIA regime, the current regime will continue to apply to them until the expiration of the licenses - section 311(2(b); section 92 of the PIA

Others

- Cash call repayment agreement
- Dispute settlement agreement
- Escrow agreement
- Buy-back contracts (Iran)
- Model Petroleum Agreement (Ghana)

CONTRACTING PARTIES: ROLES & RESPONSIBILITIES

JVA

The Parties

- Government (NNPC) and IOCs

Roles and Responsibilities

- Each partner has a percentage interest and contributes funds (cash calls) towards cost and expenses proportionate to their interests
- Parties hold interest in the assets of the joint venture in common but their liabilities are several.
- Parties receive proceeds separately and in kind.
- One of the partners is designated the operator – usually the party with the major interest
- The NNPC reserves the right to become an operator

JVA (cont'd)

- All parties are to share in the cost of operations.
- Each partner can lift and separately dispose its interest share of production subject to the payment of Petroleum Profit Tax (PPT) and Royalty.
- Each party can opt for and carry on sole risk operations.
- Technical matters are discussed and policy decisions are taken at operating committees where partners are represented on the basis of equity holding.

JVA (cont'd)

Operator's specific roles and responsibilities

- Carries out all joint operations with utmost good faith and in a good workmanlike manner
- Responsible for consulting with the non-operator(s)
- Prepares annual proposals for programmes of work and budget of expenditure which shall be shared on shareholding basis.
- Responsible for choosing its employees for the use of the joint operations which employees are considered employees of the operator and not the joint operations.
- Can enter into contract or place any purchase order concerning procurement of facilities, equipment, supplies etc. subject to limitations placed by the JOA

JVA (cont'd)

- Keeps precise records and books of account
- Litigates claims on behalf of the parties in accordance with directions of the operating committee
- Open and keep a joint bank account for deposit of operation funds by all parties
- Must make full disclosure of personal interest
- Must not to use joint venture property for personal profit
- Must account for any interest made on money held in the joint account
- Must not misuse confidential information
- Responsible for taking out insurance

PSC

Parties

Government and IOCs/Indigenous companies

Operator's roles and responsibilities

- Provide funds for payment of operating costs and funding work programmes
- Prepare work programmes and budgets and carry out approved work programmes in a good and workmanlike manner
- Submit to NNPC for permanent copies of all geological, geophysical, drilling, well production, operating and other data and reports.
- Prepare and submit PPT returns to NNPC in accordance with the PPT Act.
- Has the right to lift and freely export and to retain receipts from sail of Available Crude Oil allocated to it under the PSC

PSC (cont'd)

- Prepare and carry out programmes for industrial training and education of Nigerians with respect to petroleum operations.
- Give preference to goods and services available in Nigeria.
- Indemnify and hold harmless the NNPC from loss brought about by its wilful misconduct.
- Can finance operations from external sources under terms approved by NNPC

NNPC's roles and responsibilities

- Timely pay to the government all bonuses, royalties, concession rentals and PPT
- Assist and expedite the contractor's execution of operations
- Has title to all original data resulting from the operations
- Not to derogate rights of contractor over contract area.
- Apply for conversion of OPL to OML

Service Contract

Parties

- Government and contractor
- License holder and service provider/sub-contractor

Roles

- The State party retains ownership of the hydrocarbons.
- Contractor provides all the funding for the operations.
- Contractor is merely paid off for services rendered.
- Contractor has the option to purchase the hydrocarbons.
- Contractor bears all the risks of the operation
- Roles agreed between parties in the case of license holder service contracts on a case-by-case basis

CONTRACTING PARTIES: ROLES & RESPONSIBILITIES

SAA

Parties

NPDC and Oil company

Roles and responsibilities

- The State party retains ownership of the hydrocarbons.
- Contractor pays an entry fee
- Contractor provides all the funding for the operations.
- Contractor is merely paid off for services rendered.
- Contractor has the option to purchase the hydrocarbons.
- Contractor bears all the risks of the operation

FARM-OUT AGREEMENT

Parties

Farmor and Farmee

Roles and responsibilities

- Farmor provides the lease area
- Farmor is responsible for lease renewals and extensions
- Farmee operates on a sole risk basis
- Farmee bears the cost and expenses of operations
- Farmee pays overriding royalties based on quantum of production
- Farmee is responsible for taking out insurance on the field
- Farmee sets aside funds as security for eventual decommission and abandonment

KEY ISSUES

- Calculation(s)
- Fiscal provisions
- Secrecy of contractual arrangements – *NDAs and confidentiality clauses*
- Stabilisation and renegotiation clauses
- Excessive regulation
- Lifting obligations
- Change in government policies


Thank you!

Questions?

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