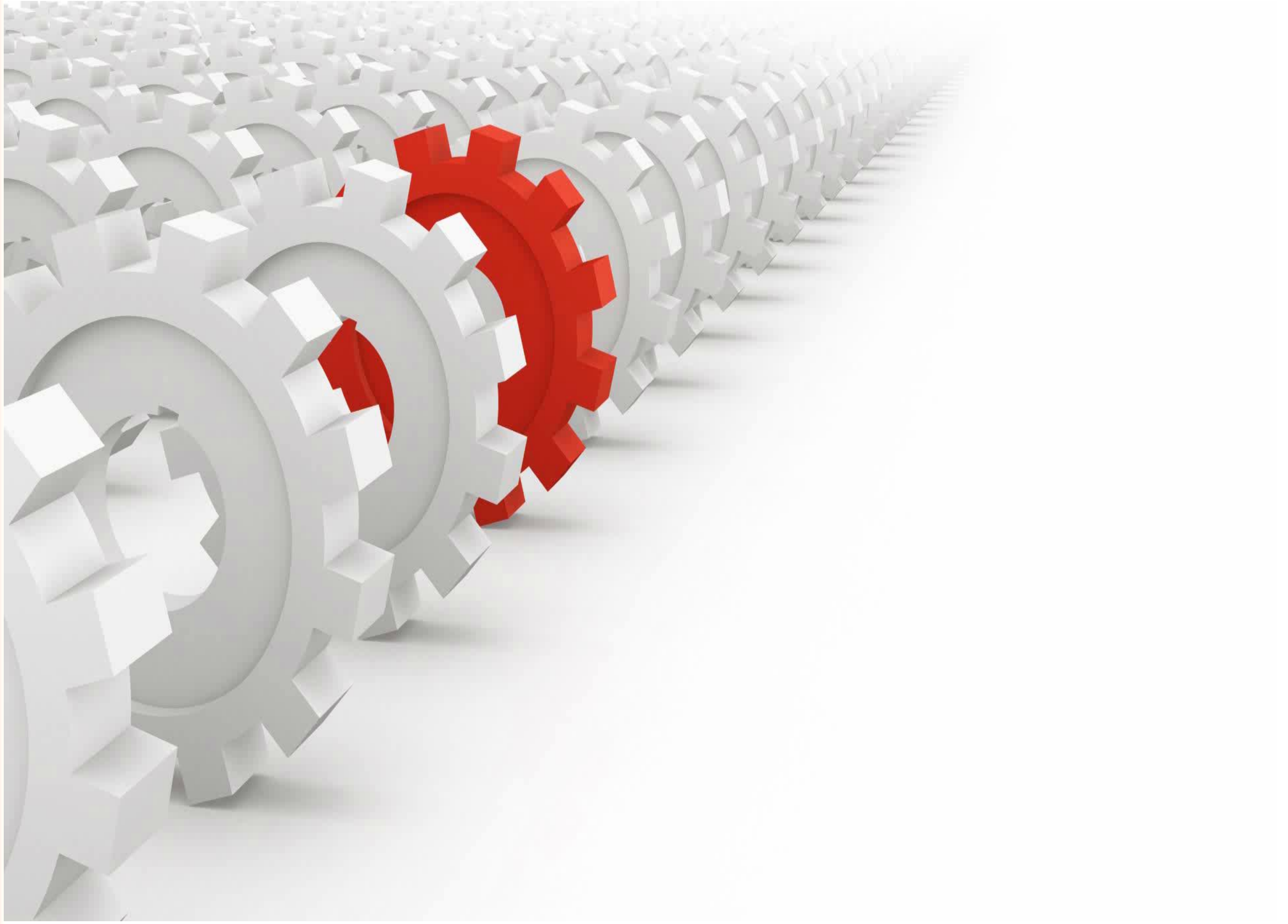

Understanding Upstream Petroleum Contracts

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Outline

- Elements of an Enforceable Contract
- Types of Host Government Contracts in Nigeria’s Upstream Sector
- Joint Venture Arrangements
- Production Sharing Contracts
- Farm-Out Agreements
- Conclusion

01 Elements of Enforceable Contract

Issues

Meaning

Sanctity

Good faith intention to perform; any variation should be by mutual consent of parties or as required by law.

Enforcement

Dispute Resolution: Arbitration and International Litigation

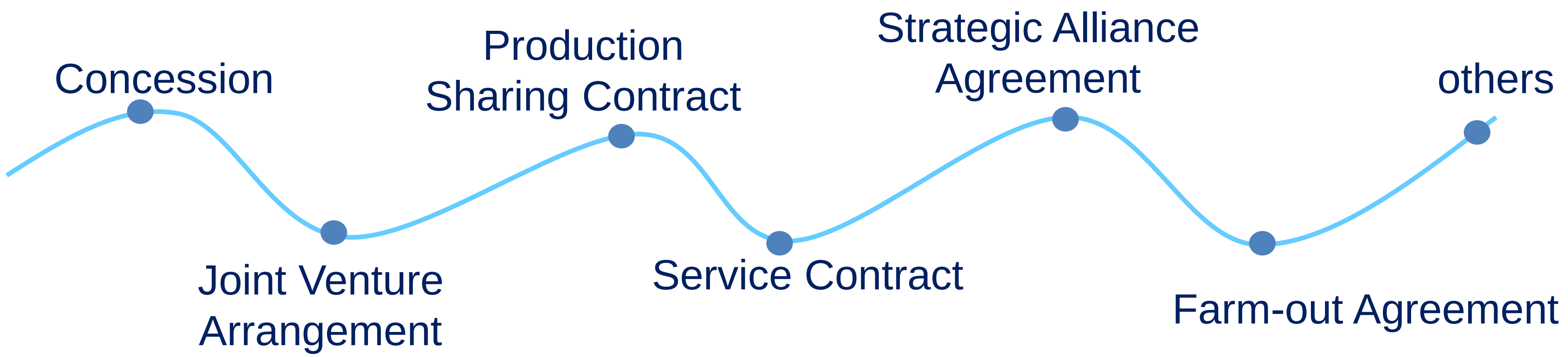
Key Elements

- Offer
- Consideration – different from a gift but mustn’t be an exchange of money.
- Acceptance – by words or conduct. Silence is not acceptance.
- Awareness, mutuality or meeting of the minds – undue influence, duress or fraud are vitiating elements.
- Intention to enter legal relations - MoU
- Capacity
- Legality
- Statutory requirements
- Perfection

02 Types of Host Government Contracts in Nigeria’s Upstream Sector

Types of Host Government Contracts

The Nigerian government has entered into different forms of contractual arrangements with IOCs and indigenous companies for the upstream petroleum sector over time.



03 Joint Venture Arrangements

Scope

PIA
2021

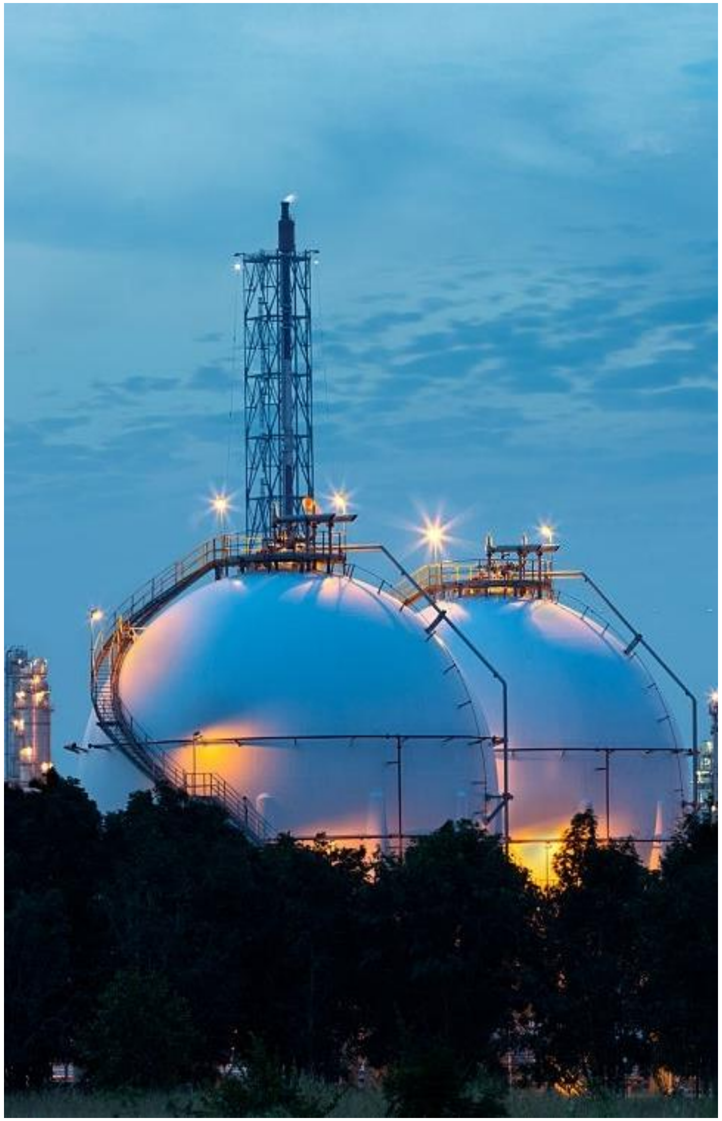
- Association or partnership between two or more parties to contribute funds or assets for exploration and production of oil for the purpose of making profits.
- Common interest in assets and liabilities.
- Operator is interposed between the participants and operations.
- Proceeds are shared and received separately.
- Incorporated or non-incorporated Joint Venture.

Suite of JV Agreements

- **Participation Agreement** – proportion of interest in the license, assets such as pipelines and flow stations.
- **Joint Operation Agreement** – sets out the guidelines and modalities for the operations.
- **Memorandum of Understanding** – formalizes incentives to guarantee RoI to investor e.g., guaranteed minimum profit of margin per barrel of oil produced.

JOA – Substantive Provisions

- **Parties** – Operator responsible for day-to-day management and non-operators. Usually, IOC with NNPC reserving the right to become an operator.
- **The Link** – Joint Operating Committee involving all the parties and decisions taken on the basis of equity holding.
- **Pre-emptive rights** - for transfer of rights to non-participating third parties.
- **Sole risks operations** - where common decision cannot be reached on an operation provided in doesn't conflict or adversely affects joint operations.
- **Funding of joint operations** – parties are to contribute funds based on equity holding.



JOA – Substantive Provisions (Cont'd)

- Cash calls - operator submits cash calls to each participant not later than 10 days prior to 1st day of the month when the expenditure is to be made.

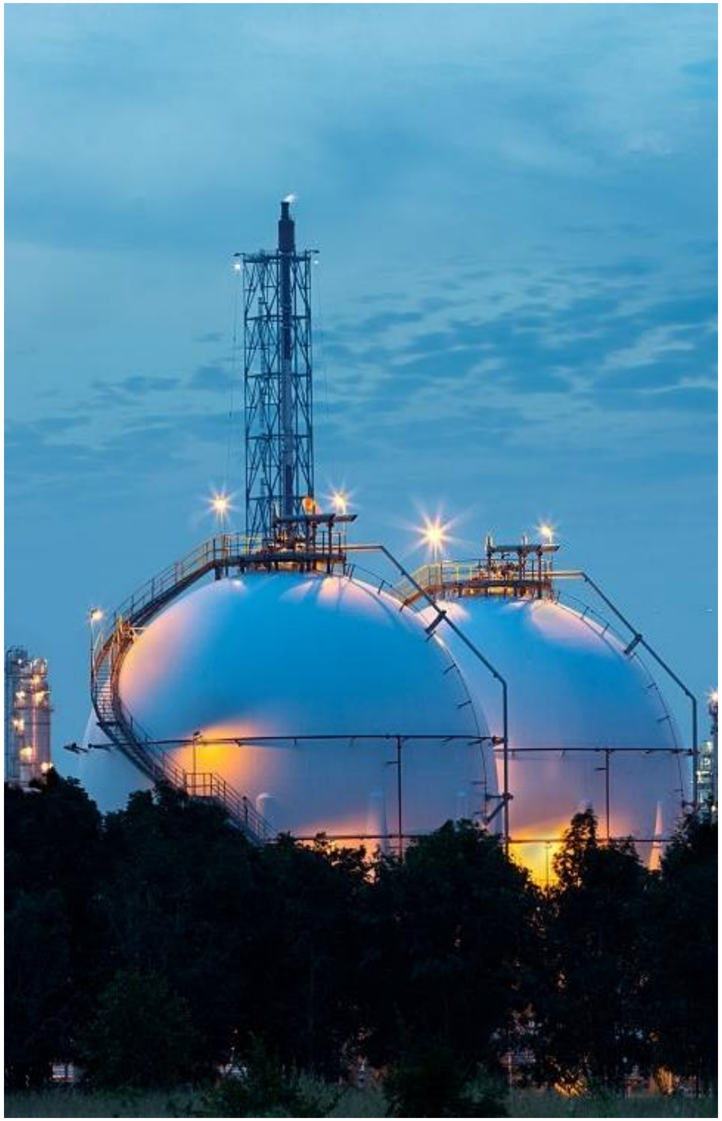
- Each party is to pay to the joint bank account by the due date or elect to pay using crude oil. A party can dispute if it exceeds the expenditure to be incurred but must pay the undisputed portion.

- **Cash calls default** – parties will agree to borrow funds, suspend or limit joint operations or agree defer payment terms.

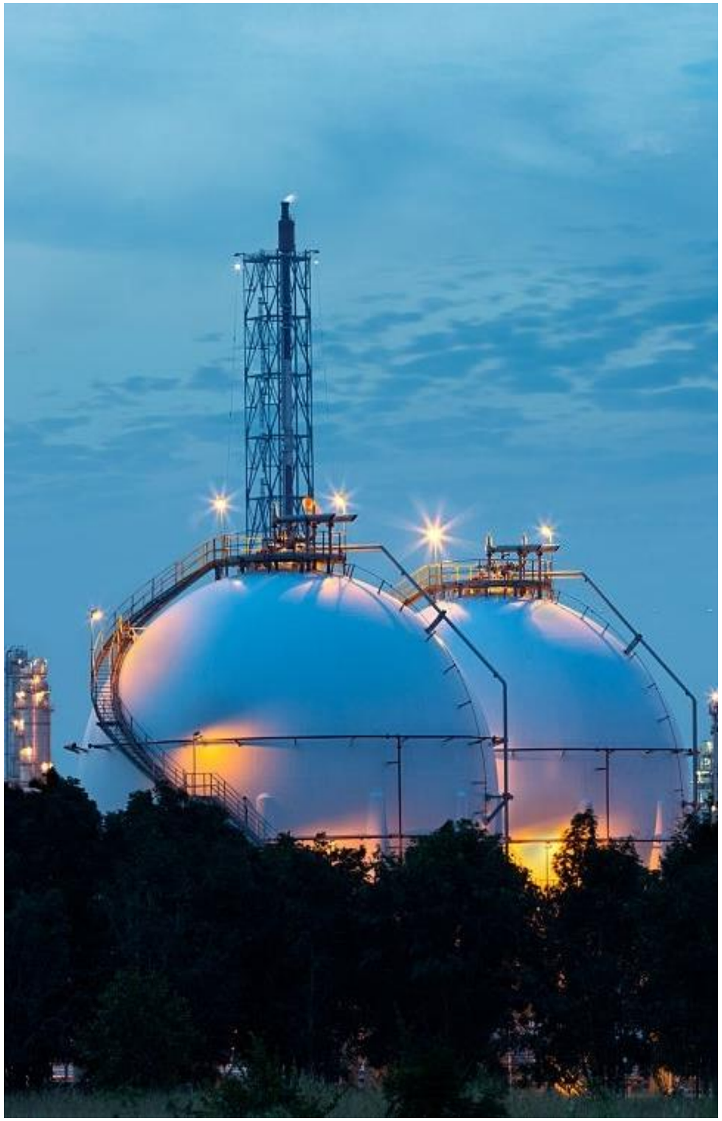
- **Cessation of operatorship** - loss of participating interest, bankruptcy or insolvency, assignment or transfer of interest, failure to rectify or remedy breaches of its obligations after notice, for transfer of rights to non-participating third parties.

- **Force majeure**

- **Governing law and dispute resolution**



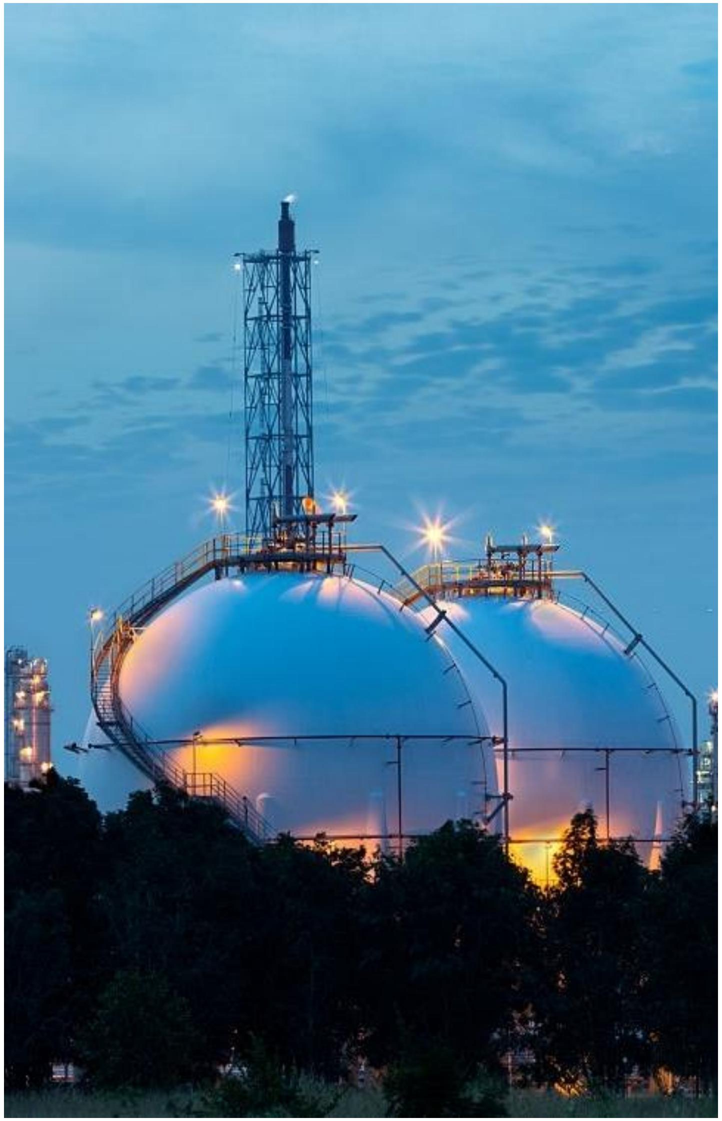
Duties and Responsibilities of Operator



- Prepares proposal for programs of work budget for joint expenditure annually to be shared pro-rata.
- Carry out all joint operations in a workmanlike manner in accordance with good industry practice and extant regulations.
- Full disclosure and consultation with non-operators on all important matters relating to the operations.
- Presenting to the JOC organization chart of management and supervisory positions of the joint operations.
- Responsibility to choose number of employees, their qualification and remuneration - usually the operator's employees.

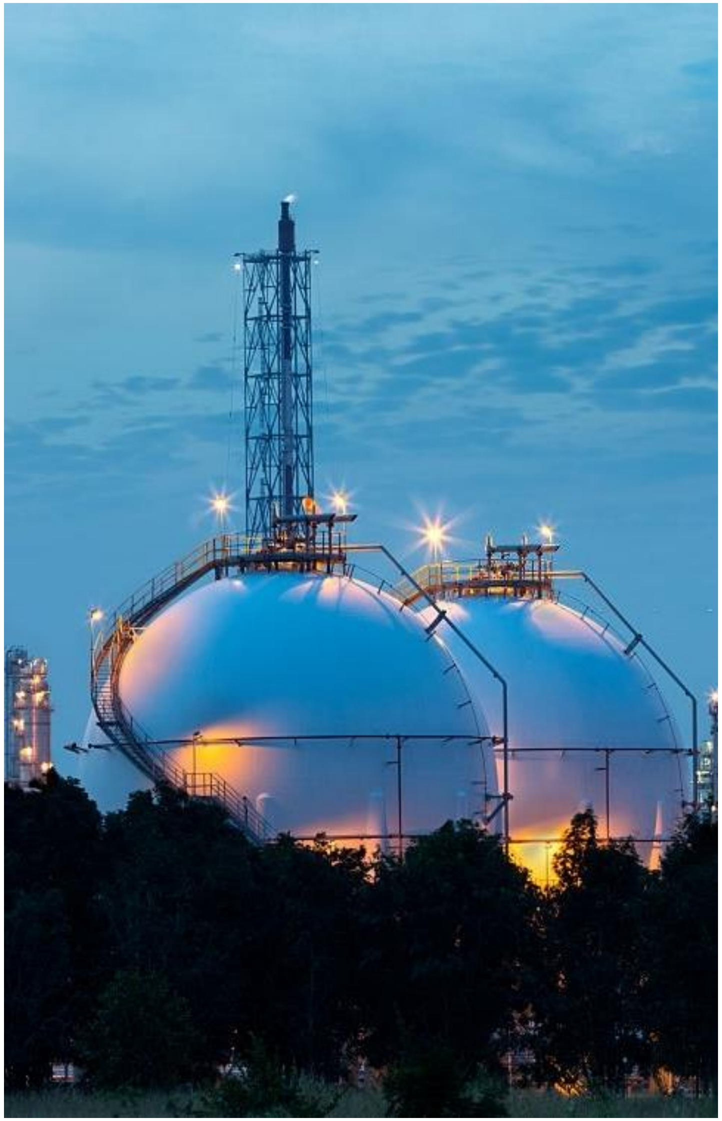
Duties and Responsibilities of Operator (Cont'd)

- Keeping of record and books of account and making them available to the non-operators during normal business hours.
- Opening of joint bank accounts and forwarding monthly statements to the non-operators.
- Responsibility to litigate and reconcile claims subject to a cap. as may be specified in the JoA.
- Fiduciary duties as a Trustee.
- Personal liability for failure to perform works in accordance with standards.



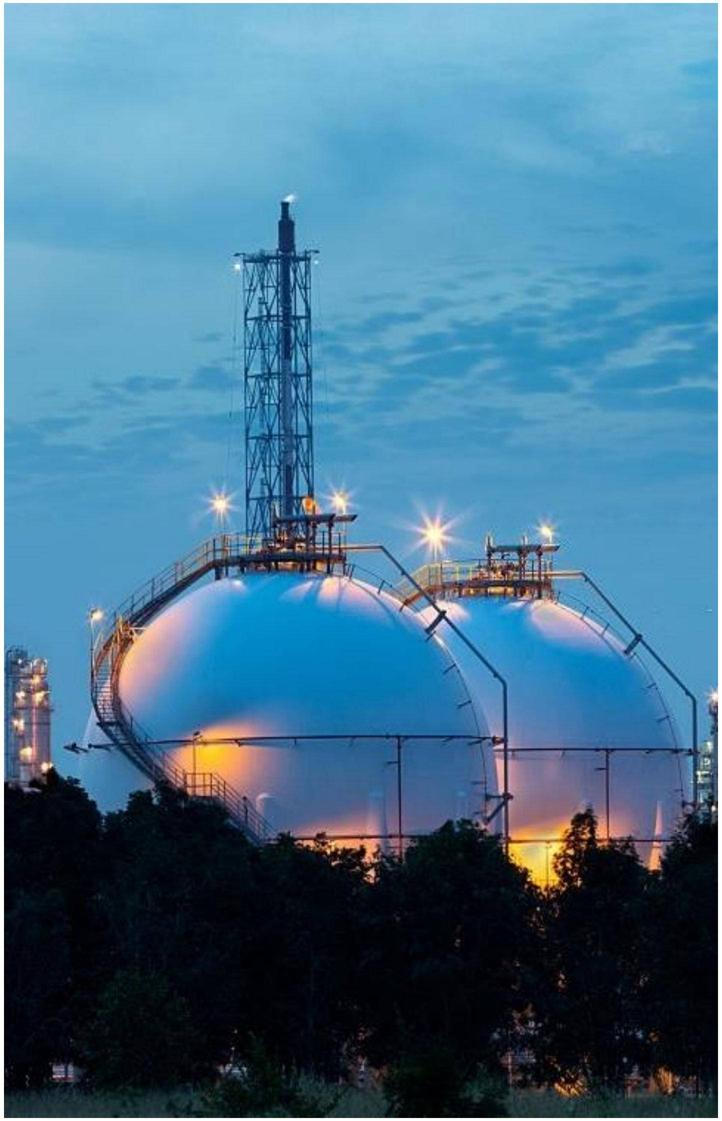
The Joint Operating Committee

- **Composition** – usually 10 persons with NNPC nominating 6 while other 4 are from the IOCs.
- **Quorum** – 5 with 3 from NNPC and 2 from the IOCs.
- **Decisions** – by voting power which means non-operator can veto matters proposed by the operator.
- Generally, acts as a check to the operator.



Powers of the Joint Operating Committee

- Approval, revision or rejection of all proposed work programmes and budgets.
- Determination of selection, scope and timing of all oil wells and facilities for joint operations and any changes to them.
- Settlement of certain claims (e.g., exceeding $300k) if not covered by policies of insurance maintained under joint account.
- General policies and methods of the joint operations.
- Abandonment and storage of joint property.
- Ensuring the operator maintains the pre-requisite accounting rules.



Challenges

- There are 6 (six) JVs with IOCs accounting for majority of oil production in Nigeria for many years.

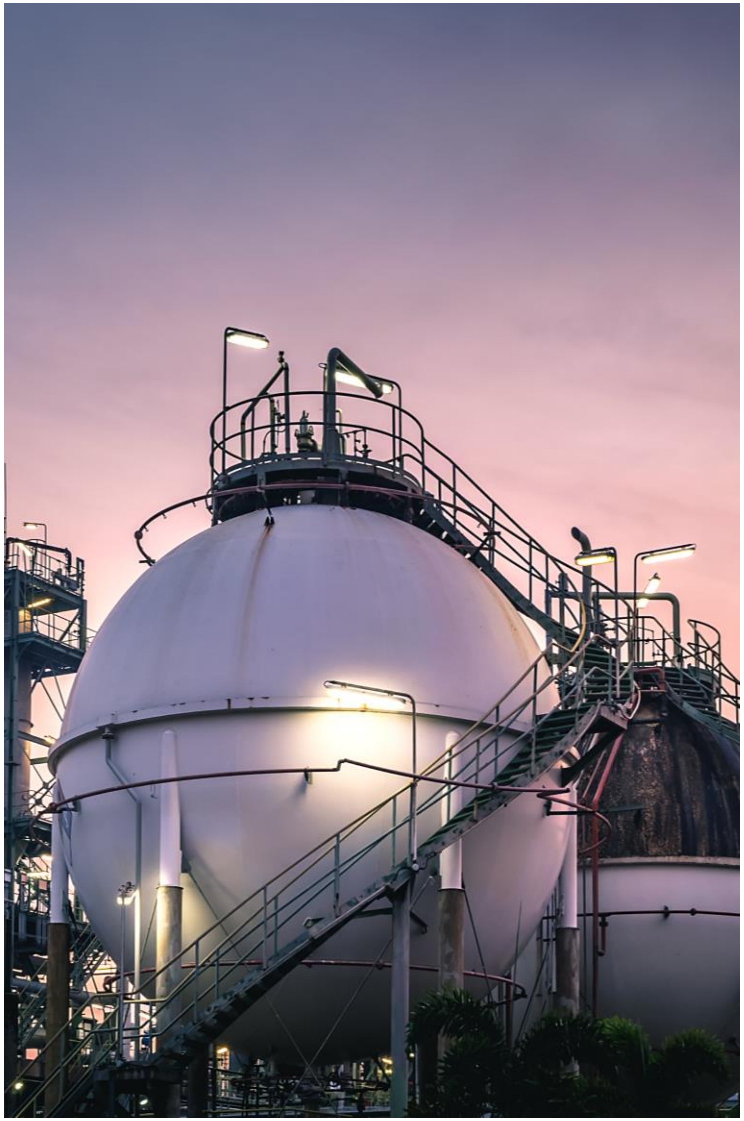
- NNPC holds largest share of 60% and 55% (in Shell) but fails to meet its cash calls.

- These are offshore assets which are facing divestments by IOCs due to oil theft, vandalism, environmental issues and unfavourable operating environments onshore.

- Divestments are mostly to indigenous firms like Aiteo, Oando and Conoil.

- Replacement of JVs with PSCs as the favourable contractual arrangement due to the need to fund inland and offshore basins and bring the needed expertise for those operations.

- PIA – allows replacement of non-incorporated JVs to incorporated JVs.



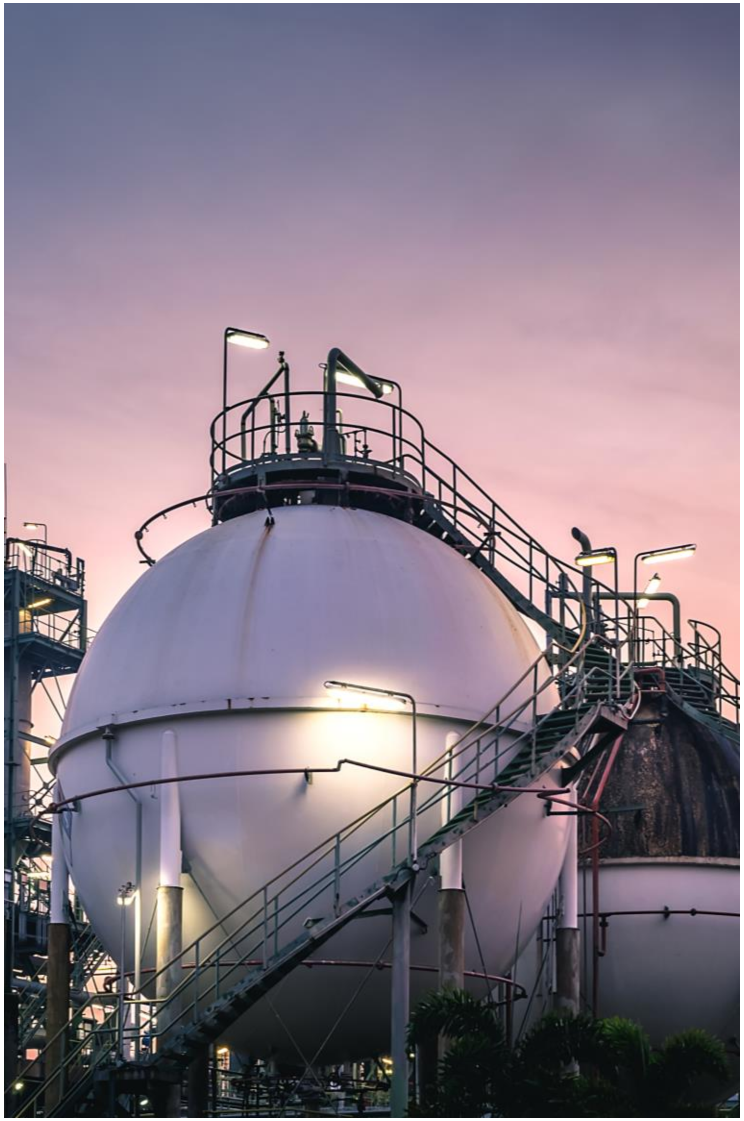
04 Production Sharing Contracts

Scope of PSCs

- A contract between IOC and host government which authorizes the IOC to conduct petroleum exploration and production in a specified area.
- Widely used in Nigeria since the early 1990s. It lifted the JV cash calls on FGN and gives more favourable fiscal and legal regimes to the IOCs. Current PSCs were negotiated in 2001-2002 in relation to deep water acreages.
- Total control and ownership of the petroleum resources is in the government, but the cost of exploration and production is borne by the IOC.
- Oil produced is allocated into Cost Oil, Royalty Oil, Tax Oil and Profit Oil which is the oil left after all deductions.
- Common in countries that lack the technical and financial capabilities.

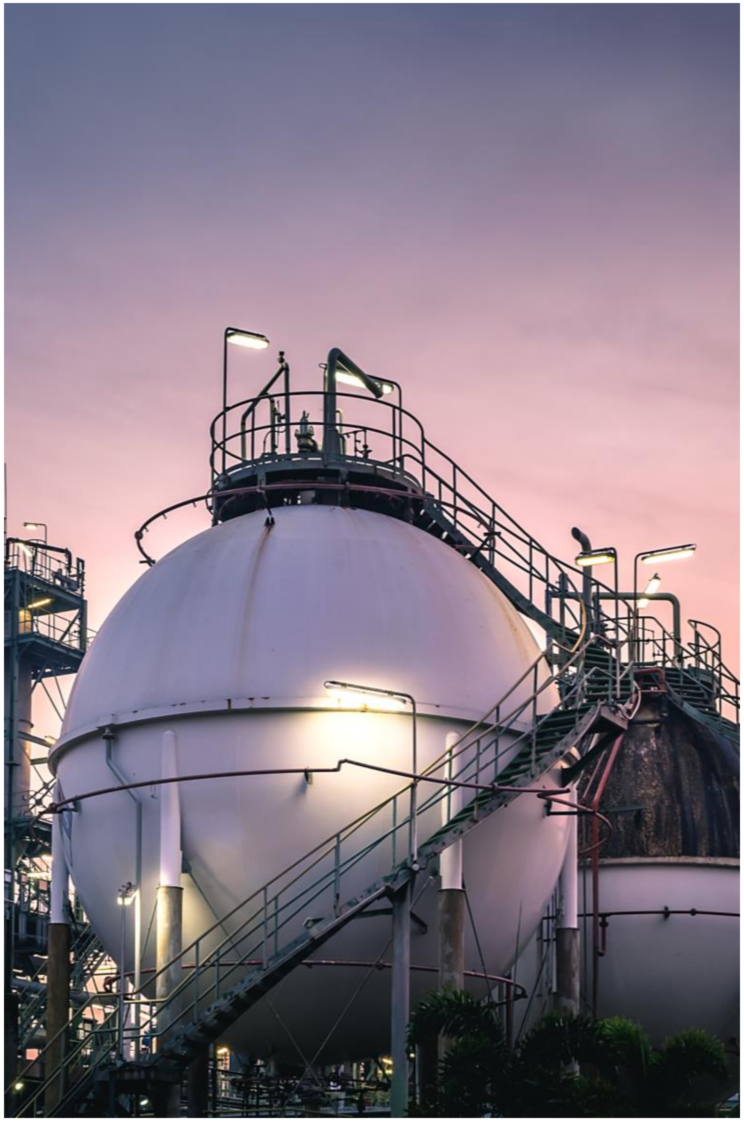
The Management Committee

- For effective control and management by the NNPC.
- 10 members with equal representation between the NNPC and the IOC.
- NNPC appoints the Chairman of the committee while the Contractor appoints the Secretary.
- Quorum is 6 members with both sides equally represented. Both the Chairman and the Contractor’s lead representative must be present.
- Expenditure exceeding $100k must be approved by the Committee. This oversight curbs wastefulness on the part of the Contractor.



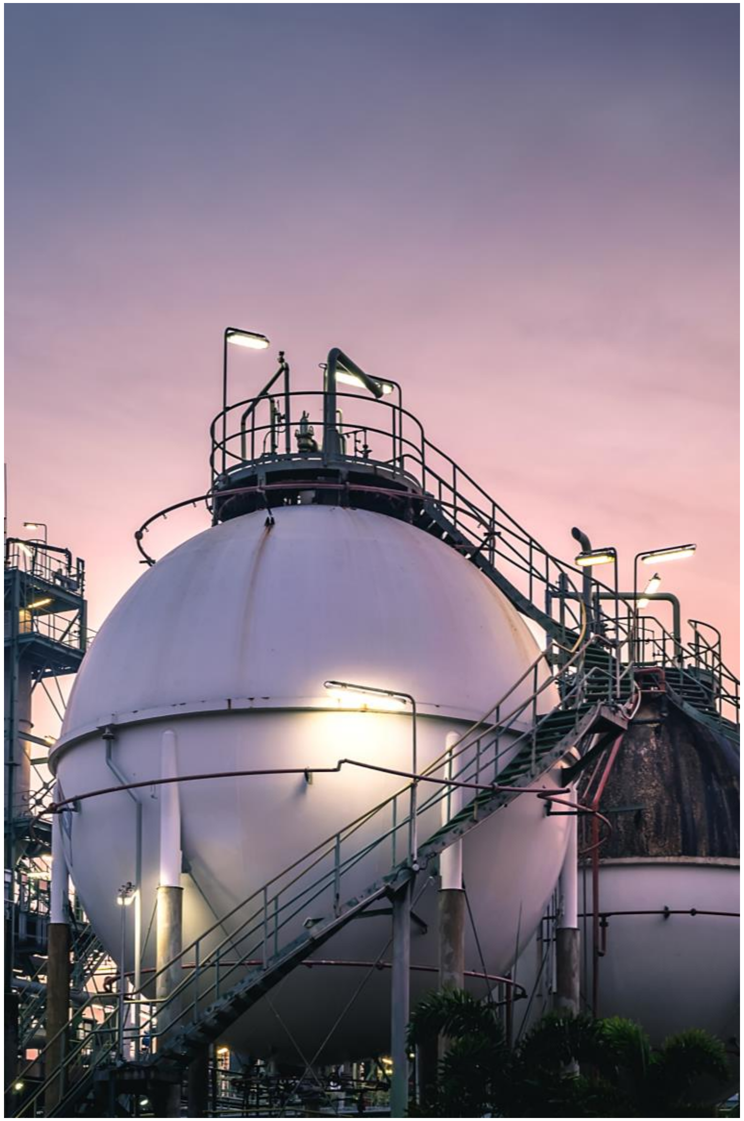
Substantive Provisions of PSCs

- The Management Committee
- Bonus – signature and productions bonuses.
- Contract duration – 30 years; 10 years for exploration and 20 years for production subject to renewal.
- Minimum work program and expenditure or relinquish.
- Provision for gas discovery and proposal for commercial development of gas.
- Renegotiation clause – to avoid unnecessary abrogation of the contract.
- Stabilization clause in the event of change in law – it freezes the fiscal terms but where a legislation arises as a result of adverse economic conditions for example, parties are to meet to agree on necessary amendments.



Deep Offshore & Inland Basin Productions Contracts Act, 1999 (PSC Act)

- The PSC Act was enacted in response to demands by foreign investors to have legal backing for the incentives granted under the PSC arrangements.
- PPT is 50% of chargeable profit.
- Investment tax credit and investment tax allowance at a flat rate of 50%.
- Payment of royalties at a graduated scale. 10% for inland basin productions and 12$ to 0% for deep offshore productions.
- Computation and payment of PPT is in US$.
- Allocation of Royalty and Tax Oil to NNPC while Cost Oil goes to the contractor.



05 Farm Out Agreements

Scope

- “Marginal fields” – under the PIA any field that has been discovered but left unattended for a period of at least 7 years, from the date of first discovery or anyone so-called by the President. It is 10 years under the Petroleum Act.
- An agreement entered by one or more OML holders, called the "farmor", and a third party who wishes to obtain a lease of the area, called the "farmee”.
- 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).

Roles and Responsibilities

Farmor and Farmee

- 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

Questions?

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