



MARGINAL FIELDS UNDER THE PETROLEUM INDUSTRY ACT 2021 – ARE FARMOUT AGREEMENTS STILL RELEVANT?

Regulatory Framework for Marginal Fields Under the PIA

The Petroleum industry Act (“PIA”) which came into effect on 16 August 2021 has introduced a new institutional, regulatory and fiscal framework for Nigeria’s petroleum industry. One of the key changes is a new acreage management system, which effectively reduces the size of petroleum acreages over time. In our publication titled, “***The Petroleum Industry Act, 2021 – What Next for Upstream Players?***”, we noted as follows:

“In effect, a concessionaire could progress from an initial PPL surface area size of 350 square kilometres to only a few square kilometres under a PML such that PMLs will now ultimately be reduced to cover only the individual commercial fields being produced. It would therefore seem that the objective of the PIA is to deter asset owners from holding on unproductively to huge tracts of lease areas as in the large parcels (1,295 square miles) held under the outgoing regime.”

This new acreage management system that results in holders of Petroleum Mining Lease (“**PML**”) only retaining ‘field - sized’ lease areas, effectively puts to rest the marginal field regime that existed pursuant to the Petroleum Act, 1969 (“**Marginal Field Regime**”). Paragraph 17 of the First Schedule to the Petroleum Act had established marginal fields as fields within an Oil Mining Lease (“**OML**”) that were either farmed out by the holder of an OML (“**Farmor**”) to a 3rd party (“**Farmee**”) to carry out petroleum operations therein, or which have been farmed out / awarded by the government to a 3rd party on account of the OML holder / Farmor not having conducted any operations in the field for at least ten years following the date of the first discovery in such field. Similar to the new PIA acreage management system, the objective was to ensure that investments are made on such fields to take them to commercial production.

The PIA consequently provides that no new marginal fields will be declared under the PIA (section 94(9)) and further provides the following transitional framework for existing marginal fields:

1. *Producing Marginal Fields* – These fields will be allowed to continue operations based on the applicable royalty rates and farmout agreement entered into with the Farmor of the marginal field, subject to the requirement that such fields convert to a PML within eighteen (18) months of the effective date of the PIA, i.e., 15 February 2023. A Farmee may therefore choose to convert its marginal field to a PML at any time after the effective date of the Act or wait till the end of the eighteen (18) month transition period, at which point the field will be automatically converted to a PML. The new fiscal framework in the PIA will become applicable to such fields as from the date of conversion to a PML.
2. *Non – Producing Marginal Fields Declared Pre 1 January 2021* – These fields which were declared marginal fields prior to 1 January 2021, will be automatically converted to PPLs as from the effective date of the PIA, with the new fiscal terms and relevant provisions of the PIA consequently applicable to the fields as from that date.
3. *Non – Producing Marginal Fields as at the PIA Effective Date that are Retained by OML Holders* – The PIA allows an OML holder to hold on to a category of marginal fields outside those discussed above for a transition period of three (3) years from the effective date of the Act. Such non-producing marginal fields must have been lying fallow without activity for seven (7) years after its discovery and not been taken over by the government as at the effective date of the PIA. The OML holder is nonetheless bound to take any of the following actions within the 3-year transition period:
 - a. present a field development plan (“**FDP**”) for the field to the Nigerian Upstream Regulatory Commission (“**Commission**”) for approval, or
 - b. farmout the field with the consent of the Commission and subject to terms prescribed by the Commission, such as the Farmee’s provision of an FDP within a defined timeline, or
 - c. relinquish the marginal field to the government.

Same as is applicable for a Farmee’s failure to present an FDP within the timeline defined by the Commission, we expect that failure of the OML holder to do any of the foregoing within the three (3) year transition period will result in automatic relinquishment of the marginal field to the government.

It is noteworthy that the marginal fields that were recently awarded by the government to successful bidders following the 2020 Marginal Field Bid Rounds (“**2020 MFBR**”) fall within the second category of marginal fields, i.e., *Non – Producing Marginal Fields Declared Pre 1 January 2021*. These fields are therefore automatically subject to the regulatory and fiscal regime under the PIA and the awardees (“**Awardees**”) are entitled to be issued PPLs by the Commission.

Continued Relevance of Farmout Agreements or Otherwise

Prior to the enactment of the PIA, the relationship between Farmees and Farmors could be likened to a landlord-tenant relationship as the Farmors retained overriding rights over Farmees conduct of petroleum operations within the marginal field. These rights and obligations of the Farmees to the Farmors were reflected in a Farmout Agreement (“**FOA**”) which *inter alia*, provided for the handover of the marginal field (including relevant field data) to the Farmee, entry into an abandonment security agreement, and Farmor’s rights in respect of data from the Farmee’s operations, review of Farmee’s annual work program and budgets, access to the marginal field, control over the farmout area and operations therein, petroleum discoveries below a defined depth, lien over crude oil production for default in making due payments, and to receive certain financial benefits in the form of overriding royalties.

Other than in respect of producing marginal fields which are to remain under the extant FOA framework until conversion of such fields to PMLs, the PIA neither mandates nor requires non-producing marginal fields that have been declared as marginal fields prior to 1 January 2021, such as those awarded under the 2020 MFBR, to enter into the traditional Farmor / Farmee relationship or execute an FOA (whether in its usual form or otherwise). Rather, the PPLs that will be issued to such Awardees should be similar in every respect to those that will be issued to the Farmors when their OMLs are converted to PMLs and PPLs under the new acreage management system, providing the awardees an independent and exclusive right to conduct petroleum operations within the licence or lease area.

Unfortunately, the process currently being followed for the 2020 MFBR, which was initiated by the now defunct Department of Petroleum Resources under the erstwhile regulatory and fiscal regime for marginal fields, required that the new Awardees only gain possession of the awarded fields and existing sub-surface data from the Farmors after signing an FOA. Through the provisions of section 92(b), the PIA has however supervened with a new reality which gives the Commission the power to issue a PPL to the Awardee, as the owner of a non – producing marginal field declared as such prior to 1 January 2021. In effect, the PIA seems to answer the long – standing question around the extent of the powers of the government over non – producing oil fields taken from or relinquished by holders of OMLs where such fields were declared as marginal fields in accordance with the Petroleum Act, i.e., no operations were conducted in the field for at least ten years following the date of the first discovery in such field. To the extent that these marginal fields were ceded to the government further to the condition of the grant of the respective OMLs and applicable law, the PIA clearly seems to treat such fields fully as a property of the government, as opposed to what was allowed to be a co – ownership in the past. This has effectively sounded the death – knell for FOAs in respect of these non-producing marginal fields.

With regards to the third category of marginal fields highlighted above, i.e., non-producing marginal fields that are retained by the OML holder and yet to be ceded to the government as at the effective date of the PIA, we

expect that in exercising its right under section 94(4)(b) to farmout the marginal field to a third party, the OML holder would be at liberty to enter into an FOA with the Farmee that entitles the Farmor to consideration for the farmout and other FOA related incidents.

Next Steps for Awardees of the 2020 MFBR

In the coming weeks and months, we expect the Commission to re-order the process around the 2020 MFBR, issue PPLs to the Awardees, either mandate the OML holders to handover the marginal fields and relevant data to the Awardees or obtain such data and directly effect or midwife the handover of the fields. Pending when the Commission takes the actions outlined above, Awardees may proceed with an application to the Commission for issuance of a PPL that certifies its right to conduct exclusive and independent operations on the field.

On a final note, due to locational reasons and the fact that OML holders have conducted some measure of petroleum operations in many of the fields awarded in the 2020 MFBR, the Awardees and OML holders are likely to require some form of agreement that provides for practicalities around the handover of the marginal field and relevant field data, the use of facilities therein, as well as the allocation of risks and liabilities between the Awardees and the OML holder pre and post the handover date.

Disclaimer: This publication is not a legal opinion and is not designed to provide legal advice. Should you require legal advice on how the PIA directly impacts your business, do not hesitate to contact us.

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