THE PROPOSED 2017 MARGINAL FIELDS BID ROUND IN NIGERIA – AN INVESTORS’ GUIDE

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The Federal Government of Nigeria (“FGN”) has through its Minister of State for Petroleum Resources (the “Minister”), disclosed plans to conduct a licensing round in the current year (2017) for the allocation of marginal fields.¹ Chief amongst the reasons suggested by commentators² and industry practitioners³ for the proposed bid round are the need to raise revenue for the country and the intention of the FGN to meet production targets of 4 million barrels daily and 40 billion oil reserves.

Historically, despite Nigeria’s large oil and gas reserves base⁴, with over 1,000 undeveloped discovered oil fields, a less than 40% production level on available acreages has, unfortunately, been the norm. To maximize the production capacity, diversify oil production sources, increase oil and gas reserves, and prevent waste, the FGN has since 1996 promoted the licensing of marginal fields.

According to the Petroleum (Amendment) Act (the “Act”)⁵, a field shall be construed as a marginal field, if: (i) a discovery has been made, (ii) the field remains unattended to for a period of up to 10 years from the date of discovery thereof, and (iii) the field is subsequently declared⁶ as a ‘marginal field’ by the President of the Federal Republic of Nigeria. So far, several fields lying and being within contract or leased areas have been declared marginal fields (many of which are yet to be allocated).

History of the Marginal Field Licensing

The first marginal field to be farmed out, following the passage of the Act, was the Ogbelle Field, which was farmed out by Chevron Nigeria Limited in 1997, although formal acquisition of the field occurred around the year 2000⁷.

¹ Details of the proposed bid round and marginal fields should be available on the Department of Petroleum Resources website, although they were not available at the time of writing. However, plans for the new marginal fields licensing bid round were exclusively revealed by the Minister in the Ministry of Petroleum Resources 2016 Score Card page 15 (accessible at http://www.7bigwins.com/wp-content/uploads/2017/01/MPR-Score-Card-2016.pdf)
² Yemi Omidare’s article on the proposed 2017 bid round - published on January 11, 2016 and is accessible at https://www.today.ng/business/energy/243700/2017-award-oil-blocks-marginal-fields-pass-pib-kachikwu
⁴ This includes an estimated 37 billion barrels of oil and 180 trillion cubic feet of gas.
⁵ No. 23 of 1996
⁶ The Act provides the statutory framework for farm-out of marginal fields in Nigeria.
Guidelines for Farm-Out and Operation of Marginal Fields (the “Guidelines”) were issued by the Department of Petroleum Resources (“DPR”) on the process, stages and application requirements for companies interested in taking part in the 2001 Marginal Fields Licensing Round. The first bid round to be formally organized by the FGN started in 2001, and concluded in 2003 with the award of 24 licenses to 31 indigenous companies.  

While a bid round was proposed for 2013 (with similar guidelines released), it never held and the 2013 guidelines did not take effect.

In total, 30 Marginal Field Licenses have been awarded since the policy was introduced in Nigeria. Of the current licensees, only around 30% of the fields have reached commercial production. The economic impact of the current state of things is debatable, as marginal field production only made up 3.05% of crude oil output between 2015 and 2016. This is far less than the projected output envisaged by the Ministry of Petroleum Resources during the award stage of the marginal fields, thus prompting the Minister to threaten the revocation of licenses for non-producing fields.

Setbacks and Challenges faced by Marginal Field Operators

The announcement of the imminent bid round for the awards of marginal fields in Nigeria is being met with open anticipation, although we would be remiss if we ignored some of the challenges faced by the current operators. From our experience advising on several marginal field issues and transactions, we are of the reasoned view that wrong technical and financial partnership is one of the key ingredients for the failure observed in the operations of many of the licensees that have performed below expectations. Specifically, many of the licensed marginal fields were allocated to companies to develop indigenous capacity. However, upon the realization that these indigenous companies did not have the technical and financial capacity to develop the marginal fields post allocation, the FGN (through the DPR) gave a concession for foreign companies to farm into these marginal fields. The farm-out to any foreign company is however subject to the parties seeking and obtaining the consent of the original farmee and the FGN.

Perhaps owing to lack of experience and due to the fact that it was the first marginal field licensing round, some of the licensees entered into financial and technical arrangements with foreign partners without proper due diligence which, in turn, failed to bring some of the aspirations of the licensees to reality.

From our experience, we are of the opinion that several of the agreements formalising the partnership were lopsided in favour of the foreign technical partners as many of the marginal fields owning Nigerian companies either did not engage the services of legal practitioners with expertise in negotiating such arrangements or did not engage legal practitioners at all until they found themselves in stormy waters. Thus, it was, in many cases, a situation where these indigenous companies are stuck to these foreign technical partners even where same failed to

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8 As at 2013 when the DPR published the Guidelines for the proposed second bid round, only 7 of the 24 first marginal fields awarded were in active production.
10 Marginal field output was pitched at 23.243 Million barrels for the period June 2015 – May 2016 against the total 751.882 Million barrels produced for the year.
11 The DPR has clarified that a foreign technical partner can hold up to 49% of a marginal field through a Nigerian registered company.
fulfil their key performance targets. The foregoing, has invariably led to the high level of failure amongst marginal fields licensees. Further, failure to conduct proper commercial and technical due diligence exercises prior to submitting bids, together with the failure of the financiers to conduct proper due diligence on key contracts that underpin such capital intensive project(s) in order to ensure that risks are appropriately allocated and not weighted against the marginal field operator solely arguably played a role in the eventual abandonment of these marginal fields. In addition, failure to appropriately draft and/or review the financing documents, as well as the technical agreements has ended up costing the operators millions of Dollars and ultimately, success on their ventures.

**Conclusion - The Way Forward**

Financing and technical capacity play a key role in preparing for a licensing bid round. At the time the first licensing bid round was conducted, international price for oil was set an average of US$27 per barrel\(^1\). Whereas in 2013 (when a licensing round was proposed but never materialised), oil price was at an average high of US$93 per barrel\(^2\). The current oil price has however seen a drop to an average of US$56 per barrel. Despite volatility in the oil market and fluctuating pricing, operating a marginal field remains a lucrative business for major industry players. There may be setbacks experienced throughout the life of the project, however, these setbacks and challenges may be minimised to a certain degree with proper financing and technical expertise.

Technical and financial partnerships have always been the most advocated solution to securing adequate expertise for successfully bringing the farmed-out marginal fields into production. For this purpose, requisite technical partnership and service level agreements need to be executed detailing the scope of service and the risk mitigating measures to ensure a smooth scale operation of the oil field. Risk mitigating measures should therefore encompass a strong understanding of relevant technical risks involved in farming into the field and the measures intended to be taken within the scope of the local Company and IOC’s scope of responsibility. However, before this, it is very important that the local awardee carries out extensive due diligence on its intending partner, on the level of their technical and financial ability, as this will in most cases determine the success of their venture.

Additionally, it is impossible to rule out the need to provide adequate internal structuring both within the oil company with particular attention to decision making structure, fund management and HSE standards amongst other key areas as they all play critical roles in ensuring smooth operation of the marginal fields. To achieve the foregoing, experienced professionals (including legal practitioners) should be engaged.

Further, there is the need to ensure the accuracy of data collected from frontier areas and proper interpretation of such data as this will aid when deciding which marginal field(s) to bid for.

The FGN should also encourage long term investments in marginal fields by considering staggered/structured payment of signature bonuses with a certain mechanism and formulae to make such payment and stringent penalties for defaulting companies. This should replace the huge front-end payment which is currently the norm as there is need to strike a ‘win-win’ situation between the FGN and the prospective indigenous awardees and ultimately support the current local content policy in the Nigerian oil and gas industry.


\(^{13}\) Ibid
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