ARTICLE SERIES

# INVESTING IN MARGINAL FIELDS - KEY CONSIDERATIONS FOR FINANCIERS

JUNE 2021

www.aelex.com

It is no longer news that the winners of the '2021 Marginal Field' bid round (hereinafter referred to as grantee(s) have emerged. As grantees and potential financiers contemplate how to raise capital and the means of raising capital for the development of each field, they also need to consider certain issues that arise from the marginal field award process and other peculiarities of a marginal field.

Any bid for a government asset in Nigeria is keenly contested. Such bids attract a long list of bidders, including skilled commercial and technical operators and others who know little about the asset to be sold or the sector within which the asset operates. The 2021 Marginal Field bid round is no different. The fact that the assets being considered for sale are oil and gas assets has further intensified the competition, which is characteristic of the sale of a public energy asset in Nigeria.

It was, therefore, not surprising that upon the invitation by Department of Petroleum Resources ("DPR") for submission of Expression of Intent ("EoIs"), hundreds of aspiring companies responded. At the end of the bidding process, the DPR awarded 57 marginal field assets to 161 companies by grouping together different bidders as winners of specific marginal field assets [1]

The manner of the award of the marginal fields, by DPR, with its amalgamation of bidders for some assets, throw up unique issues and challenges that the grantees and their potential investors must consider. This article discusses the items/issues that parties need to consider when seeking or contemplating investing in the new marginal fields.

## THE INTEGRITY OF THE BID PROCESS

The Marginal Fields Bid Round Portal published the bid process as consisting of nine steps beginning with registration and pre-qualification and ending in the execution of a farm-out agreement between the leaseholder and the grantee. The DPR published Guidelines for The Award and Operations of Marginal Fields in Nigeria ("the Guidelines") [2] to guide the process. The Guidelines, amongst other things, contained extensive provisions on the award process and the criteria for evaluation and selection of the winning bids. The principles that undergird the award process are (i) that prequalified bidders must bid for specific fields, (ii) that each bid is separate and would succeed or fail on its own account.

The first principle can be gleaned from Paragraph 5.3 of the Guidelines, which required bidders to pay fees announced by the DPR for activities which includes data prying, data leasing, competent persons report and fields specific reports.

[1] See Marginal Oilfields: Bid Winners Paying Signature Bonuses – Sylva – Department of Petroleum Resources (dpr.gov.ng)
[2] Published by the DPR In 2020, available at https://www.dpr.gov.ng/wp-content/uploads/2020/08/Guidelines-for-the-Award-and-Operations-of-Marginal-Fields-in-Nigeria.pdf

The applicable fees for these activities are published in the appendix to the Guidelines. The items that bidders paid for provide the bidders with the required information that would assist each bidder in deciding on the specific field to bid for, the bid price for that specific field, the signature fees for that specific field, etc. In addition, Paragraph 5.4.7 of the Guidelines requires each bidder to indicate in its bid the specific field or fields it is interested in. Thus, a fundamental assumption underlying the bid process is that bidders would submit bids for specific marginal field(s).

The second principle becomes obvious from Paragraph 6.3 of the Guidelines, which provides that the bid round will be based on competitive participation by **interested companies** (emphasis mine). Since each bidder is required to submit a bid for a specific field, interested companies would be those companies that submitted a bid for the field. The competitive participation for a particular field would be expected to be amongst bidders who submitted bids for that field.

It appears that, the DPR, in the award of the marginal field assets, has adopted a different procedure from what was advertised under the Guidelines. Grantees and potential investors should, therefore, expect that there would be several bidders that will be aggrieved by the award process adopted by the DPR. Such aggrieved bidder(s) may challenge the award of a marginal field on the ground that the bid procedure as advertised to the bidders were not followed.

Critical questions that a court would need to answer, and which should be considered by all asset winners and investors, are (i) is the Guidelines a statutory instrument which stipulates a process that DPR is required to follow?; and (ii) does the Guidelines constitute a contract, or is it merely an offer to receive offers?

***Is the Guidelines a statutory instrument?***

Section 9 of the Petroleum Act [3] gives the Minister of Petroleum the right to make regulations prescribing anything requiring to be prescribed for the purpose of the Act.

By virtue of Section 10 of the Nigerian National Petroleum Corporation Act [4] ("the NNPC Act"), the Minister has the power to delegate to the chief executive of the Inspectorate (which later transformed into the DPR) [5] those powers conferred on the Minister under the Petroleum Act (amongst other enactments). In addition, section 10 of the NNPC Act provides that any regulatory function conferred on the Minister of Petroleum, under any enactment (and this will include the power to issue regulations) is deemed to have been conferred upon and may be discharged by the chief executive of the Inspectorate (i.e. the Director DPR) [6]

[3] Chapter. P10, Laws of the Federationof Nigeria, 2004
[4] Chapter N123. Laws of the Federal Republic of Nigeria 2004
[5] The Nigerian National Petroleum Corporation ("the NNPC")was re-organised in 1988: The Petroleum Inspectorate was removed from the NNPC, transferred to the Ministry of Petroleum Resources as the technical arm and renamed the DPR. See https://www.dpr.gov.ng/history-of-dpr/
[6] Supra note 5

From the foregoing, it is evident that the director of the DPR has, via statutory fiat, been delegated by the Minister to issue regulations including guidelines, standards, and procedure guides for purposes of the Petroleum Act.

'Regulations' is defined to mean "the act of regulating; a rule or order, having legal force, usually issued by an administrative agency; also termed agency regulation; subordinate legislation; delegated legislation" [7] The inference drawn from the above definition is that regulations, where issued by an administrative agency that has been statutorily authorised to so issue, is a subordinate legislation having legal force. Consequently, the Guidelines issued by the DPR for the award and operations of marginal fields is a statutory instrument.

Since the Guidelines is a form of subsidiary legislation, it can be taken as a statutory instrument that has stipulated the procedure to be adopted by both the bidders and the DPR for the administration of the bid process. Thus if an aggrieved bidder can show that DPR has not followed its own Guidelines, it may be a ground to challenge and upturn the award of a marginal field.

***Is the Guidelines a contract?***

Another ground on which an aggrieved bidder may challenge the recent awards of marginal fields is that the Guidelines constitute a contract, that is, a process contract between each bidder and the DPR.
Although there is no decided matter on the nature of a Request for Proposal (RfP) or EoI in Nigeria, the trend in many common law jurisdictions is that RfPs and EoIs do not constitute a contract [8]. They are considered an invitation to treat, advertisement to receive an offer, which will culminate in a contract when accepted by the principal [9].

However, there are several judicial decisions in many common law countries that, whilst affirming that an RfP/EoI is not a contract, have held that an RfP/EoI creates an underlying contract within the procurement process. This is referred to as a process contract. A process contract is an implied contract between the issuer of an RfP and the tenderer. The issuer commits to run a tender adhering to a specified process and to evaluate the bids using specified evaluation criteria.

**[7] Henry Campbell Black, "Black's Law Dictionary", Black's Law Dictionary 9th Edition (West Group, 2009), Bryan A. Garner, editor, ISBN 0-314-19949-7**
**[8] Shivas & Westmark Investments Ltd v BTR Nylex Holdings NZ Limited & Ors [1997] 1 NZLR 318 (HC)**
**[9] This is in line with the principle enunciated by**

In *Hughes Aircraft Systems International v Airservices Australia* [10], the party that issued a tender changed the advertised procedure for conducting the tender. In that case, the court decided that the party that issued the tender breached a process contract and that the aggrieved party was entitled to both damages and equitable remedies. The basis of the court's decision was, amongst others, that the tender document established a legally binding process between the principal and each tenderer and that the principal ought to follow the process and act in good faith.

Courts in other common law countries have made similar decisions. In *Pratt Contractors Ltd v Palmerston North City Council,* [11] the court held that an issuer breached the requirement to accept the lowest conforming tender, while in *Onyx Group Ltd v Auckland City Council* [12], the court held that the issuer breached an implied term that tenders would be assessed on a fair and even-handed basis. The rationale adopted in deciding that an RfP/EoI may constitute a process contract may persuade Nigerian courts to reach a similar decision [13].

## THE PROMOTERS

It will be necessary for financiers to assess who the promoters are to understand the level of their commitment to the development of the field. The background and track of the promoters are essential in making this judgement. This task will be a complicated one for parties interested in investing in the newly awarded marginal bids. The reason is that during the bidding stage, several bids were submitted by a consortium of sponsors. Members of each bidding consortium had sorted how they will manage and fund the operation of specified fields if they succeed. However, the amalgamation of competing and, sometimes, non-competing bidders as winners of a marginal field may have complicated the carefully designed arrangements that each bidding consortium had.

If winners decide to move ahead under the composite structure imposed by the DPR, the different promoters must work on a new arrangement. They may also need to form a new joint venture. This may necessitate negotiating new shareholders or unincorporated joint venture agreements. In some cases, both may be necessary. It is therefore crucial for lenders and investors to understand the corporate structure of the grantees, the contractual dynamics between the different promoters of the grantees, the structure of their different constituent companies and their different cultures.

**[10] [1997] 76 FCR 15**
**[11] [1995] I NZLR 469**
**[12] [2003] 11 TCLR 4**
**[13] Ibid**

Investors and lenders will also need to understand the strategy that would be utilised to ensure that the different sponsors are able to work amicably to operate the marginal fields peacefully and profitably.

Another important issue for investors and lenders is the question about who the promoters are. Investors and lenders would be concerned about the credibility andpedigree of the persons behind the grantee company. In cases where some of the promoters are politically exposed persons, the lenders and the investors may need to conduct extra due diligence to understand the sources of their funds.

## CORPORATE GOVERNANCE

Again, the amalgamation of bidders as winners raises the importance of corporate governance of the grantee company or the unincorporated joint venture set up for the operation of the marginal field. Lenders and investors need to take a close look at the structures and the processes that the promoters have developed to control the grantee company and, in the case of an unincorporated JV, for the conduct of petroleum operations. In order to attract investors and/or make the project company attractive to lenders, it is imperative that the promoters carefully craft the relationships amongst all the stakeholders (the management, the board, the shareholders (majority and minority) in a manner that would be adjudged fair and equitable.

This may help ensure that the grantee company remains feasible and sustainable. The structure of the grantee boards and the stature of the persons constituting the said board are also issues the lenders and investors should pay close attention to. Thus, the grantees should be willing to appoint persons with demonstrable track records and good ethics to their boards.

The management team should be carefully scrutinised by lenders/investors. They would need to ascertain that the grantee has a team that consists of persons with technical, financial, and commercial expertise. It will be a plus for the grantee to demonstrate that it has a team that knows how to achieve production with minimal costs. A grantee with a cohesive team with a history of working together will be a positive signal to lenders and investors.

## THE QUALITY OF THE ASSET

By its nature, a marginal field in Nigeria is one that has been left unattended for not less than ten years after it has been discovered [14] A key reason such fields are left unattended is that the licence holder did not, for several reasons, consider the fields to be economically viable. Lenders and investors are aware that the mere fact that marginal field licence has been granted for such field will not change the economic viability of such field.

**[14] See pg 8 of the guidelines**

For such a field to be considered an asset that would attract debt or equity, the grantee must improve the quality and economics of the asset.

The grantee needs to demonstrate to lenders and investors that the asset has sufficient reserves to guarantee attractive upsides, notwithstanding the prevailing fiscal and market terms. It will be important to show that the field is connected to critical infrastructure for crude evacuation. It will be a bonus if the grantee can provide other viable alternative evacuation outlets that will come in handy if the primary evacuation infrastructure fails. Lenders usually require evacuation options in view of the losses that operators typically suffer, such as losses during crude transportation and handling by third parties. A viable alternative evacuation option will also help allay the fears of lenders and investors over production shut-downs, occasioned by frequent force majeure occurrences on crude handling infrastructures.

Where the marginal field has associated gas, the grantee needs to provide a convincing and bankable gas development and utilisation plan. The zero-flare policy of the government will mean that a new marginal field with associated gas may not be produced without a gas utilisation plan. Also, a detailed and comprehensive environmental, safety and health management plan/system will need to be developed, not only for compliance purposes but also for improving the quality and attractiveness of the marginal field.

In view of the current global energy transition, it is crucial for the grantee to develop an excellent strategy to convince sceptical investors or lenders on the long-term viability and profitability of the asset. Lenders and investors would like to know how the marginal field grantee will adapt to changing policies around the world and its plan to evolve in a way that would continue to make the company profitable.

Above all, the grantee needs to show that it can minimise operational and technical costs whilst deploying an operating model that accelerates recovery and converts production in the tank into profit in the bank.

## OTHER COMMERCIAL CONSIDERATIONS

The profitability of the marginal field will form a significant concern for the investors. Given the report that the Federal Government of Nigeria intends to generate US$500million from signature bonus [15] payable by the grantees, it is necessary that a grantee seeking loan and/or equity investment demonstrates the profitability of the fields. Investors and lenders would expect the grantees to show that the field will be profitable despite the low reserves of marginal fields, low oil price, subsurface uncertainties, and technological constraints.

[15] Report available at https://www.dpr.gov.ng/dpr-targets-500m-from-signature-bonuses-of-57-marginal-oilfields/

## LOAN SECURITY

The lenders will require that the grantee arranges robust security for the loans. Loans for petroleum asset acquisition and development are usually structured as pre-export loans [16] In this respect, the primary source of repayment is the revenue generated from the sale of oil and gas produced from the asset. As expected, under pre-export loans, the revenue generated by the asset would be charged in favour of the lenders. However, in addition to creating a charge on the revenue, elements of corporate finance are introduced, such as the creation of charges over the shares of sponsors and the requirement of providing corporate and personal guarantees of the sponsors.

Lenders will need to satisfy themselves as to the effectiveness of creating charges over the marginal field licence and the shares. There is the often recurring issue about the difficulty of enforcing the charges created over petroleum assets and shares of a petroleum company because of the requirement for Minister's consent at the point of enforcement of the security created. Hopefully, this issue would be resolved if section 95(5) of the Petroleum Industry Bill (PIB) is passed as proposed.

The section allows for asset owners to charge their rights with the consent of the regulator. Whilst the passage of section 95 may resolve an age-long problem, banks will face another problem regarding charges created over shares. Section 20920 of the Banks and Other Financial Institution Act 2020 requires banks to obtain the consent of CBN before enforcing their rights over shares charged as security [17]

## CONCLUSION

Marginal fields, by their very nature, have limited capacities to attract debts and equities. In view of the currency instability, currency exchange constraints and the existing exposures of Nigerian banks to the petroleum sector, fewer and fewer oil and gas deals are getting financed. The marginal field grantee needs to develop a robust strategy for obstacles and litigation that may arise as a result of the award process. It is also necessary for a marginal field grantee to carefully balance the different interplays between the size of the reserves, costs, oil price and the fiscal regime in order to build an operation that is optimally geared to support decent returns for investors and lenders.

**[16] Lexisnexis, "Pre-Export Finance and Pre-Payment Finance Overview" available at https://www.lexisnexis.com/uk/lexispsl/bankingandfinance/document/391289/5617-JTC1-F185-X3X6-00000-00/Pre_export_finance_and_prepayment_finance_overview**
**[17] Section 20(2) BOFIA Act No. 5 2020**

ÆLEX

Olusina Sipasi
Partner, Aelex

ÆLEX is a full-service commercial and dispute resolution firm. It is one of the largest law firms in West Africa with offices in Lagos, Port Harcourt and Abuja in Nigeria and Accra, Ghana. A profile of our firm can be viewed here. You can also visit our website at www.aelex.com to learn more about our firm and its services.'

# CONTACT DETAILS

**LAGOS, NIGERIA**

4th Floor,
Marble House
1, Kingsway Road, Falomo
P. O. Box 52901, Ikoyi
Lagos, Nigeria

Telephone: (+ 234 1) 2793367; 2793368
4736296, 4617321-3;
Facsimile: (+ 234 1) 2692072; 4617092
E-mail: lagos@aelex.com

**PORT HARCOURT, NIGERIA**

2nd Floor,
Right Wing UPDC Building
26, Aba Road
P.O. Box 12636, Port Harcourt
Rivers State, Nigeria

Telephone: (+234 84) 464514, 464515
574628, 574636
Facsimile: (+234 84) 464516, 574628
E-mail: portharcourt@aelex.com

**ABUJA, NIGERIA**
4th Floor,
Adamawa Plaza
1st Avenue, Off Shehu Shagari Way
Central Business Area
FCT Abuja, Nigeria

Telephone: (+234 9) 8704187, 6723568,
07098808416
Facsimile: (+234 9) 5230276
E-mail: abuja@aelex.com

**ACCRA, GHANA**

7th Floor, Suite B701
The Octagon
Accra Central, Accra
P.M.B 72, Cantonment Accra, Ghana

Telephone: (+233-302) 224828, 224845-6
Facsimile: (+233-302) 224824
E-mail: accra@aelex.com