TEMPLARS

Casting A Wide "*Back-In*" Net

AN EVALUATION OF THE NEW LEGAL FRAMEWORK FOR THE NEGOTIATED PARTICIPATION OF THE FEDERAL GOVERNMENT IN OIL BLOCKS

In February 2019, the President in his capacity as the Minister of Petroleum Resources and pursuant to sections 9(1)(a) and (9)(1)(h) of the Petroleum Act[1], and paragraph 35(a) of the First Schedule to the Petroleum Act made the Oil Block Allocations to Companies (Back-In-Rights) Regulations ("**New Back-In Regulations**"). The New Back-In Regulations revoked the Deep Water Block Allocation to Companies (Back-in-Rights) Regulations of 2003 ("**Old Regulations"**) which, until the revocation, restricted the Federal Government's back-in right to participation in oil prospecting licences and oil mining leases awarded only for **deep water blocks.**

In what we would consider significant, and a departure from the Old Regulations, the New Back-In Regulations cast a wide net over **all** oil prospecting licences and oil mining leases, whether onshore, shallow or in deep water, thereby entitling the Federal Government to participate in any venture to which an oil prospecting licence ("**OPL**") or oil mining lease ("**OML**") relates. This right may be exercised by the Federal Government at the commencement date of an OPL, or upon the conversion of the OPL to an OML or at the renewal of the OPL or the OML. Another feature of the New Back-In Regulations is the apparent fidelity to the decision of the Supreme Court in *NNPC v. Famfa Oil Ltd*[2] on the appropriate procedure for the Federal Government's exercise of its back-in rights.

CHANGES AND INNOVATIONS UNDER THE NEW BACK-IN REGULATIONS

A comparison of the New Back-In Regulations with the Old Regulations reveals significant changes to the legal framework for the exercise of the Federal Government's right to participate in oil prospecting licences and oil mining leases.

Scope of the Federal Government's Participation

Under the Old Regulations, the Federal Government's right to participate in OPLs and OMLs by the acquisition of the allottee's interest was limited to OPLs and OMLs issued in respect of deep water blocks (i.e. *concessions for the exploration and/or exploitation of petroleum in which all or part are in waters deeper than 200 metres*). However, the New Back-In Regulations have erased this limitation by enabling the

[1] Cap.P10, Laws of the Federation of Nigeria,2004.
[2] NNPC v Famfa Oil Ltd [2012] 17 NWLR, (Pt. 1328) at page 160.

Federal Government to back-in to any oil block covered by an OPL or OML.

Also, the language adopted in the Old Regulations arguably, suggests that the Federal Government, in the exercise of its rights, is mandated to acquire, at once, five-sixths of the interest of an "***allotee***" in the relevant OPL or OML. However, the New Back-In Regulations soften the mandate by introducing some flexibility with the use of ***"up to"***. Specifically, the New Back-In Regulations stipulate that the Federal Government may acquire ***"up to"*** five-sixths of the interest of an "**applicant**", suggesting that the Federal Government may acquire less than five-sixths and may therefore exercise this right at different intervals within the confines of the New Back-In Regulations until it has attained a maximum of five-sixths.

A controversial issue in the Old Regulations was the quest to determine the point in the life cycle of an OML or an OPL that the Federal Government may back-in. This controversy is heightened by the use of "allottee" in the Old Regulations and it is often argued that the Federal Government may only back in at the commencement of an OPL or OML. It is worthy of mention that the New Back-In Regulations have cleared this controversy as the term **"applicant"** refers to a company applying for an award of an OPL or OML, conversion of an OPL or renewal of an OPL or OML. This implies a further prescription (not previously provided for under the Old Regulations) on the time when the Federal Government may back- in.

Regulated Negotiations – Lessons from *Famfa*

Another feature of the New Back-In Regulations is the apparent fidelity to a 2012 decision of the Supreme Court on the appropriate procedure for the Federal Government's exercise of its back-in rights.

The Supreme Court, in *NNPC v. Famfa Oil Ltd*[3] ("***Famfa***"), relied on the provisions of section 44 of the Constitution of the Federal Republic of Nigeria, 1999 (as amended) and the First Schedule to the Petroleum Act, to hold that the Federal Government's exercise of its back-in right must be subject to negotiations between the Federal Government and the relevant party against whom the back-in right is to be exercised. Where no negotiations are held, any unilateral exercise of back-in-rights by the Federal Government would be invalid.

In alignment with *Famfa*, the New Back-In Regulations set out an elaborate procedure for the exercise of the Federal Government's back-in rights, including a negotiation process as required by Paragraph 35(a) of the First Schedule to the Petroleum Act. The Minister of Petroleum Resources ("**Minister**") has an obligation to invite the applicant for negotiations in respect of the terms for the acquisition after giving such applicant a minimum of 14 days' notice of the date, time, venue of such negotiations.

This initiative is laudable. However, the enthusiasm slowly ebbs away when one considers the fact that an acquisition of participating interest by the Federal Government will still have full force and effect on an applicant even if the Minister and the applicant are unable to reach an agreement on the terms of participation during the negotiation. Even though the New Back-In Regulations preserve the right of the applicant to resort to arbitration, the greater concern is whether there can ever be a balance of bargaining power at the negotiation table.

Salient Points on recovery of Proven Costs

Within the rubric of negotiations to be had between the Minister of Petroleum Resources and an applicant, the New Back-In Regulations permit the applicant to recover all unrecovered Proven Costs within the following parameters:

- To be characterized as Proven Costs, the costs must qualify as "*expenditure made and obligations incurred exclusively, wholly and necessarily for the purpose of carrying out petroleum operations in respect of the OML or OPL*," which entails that the so-called WEN Test (i.e. *wholly*, *exclusively* and *necessarily*) will be applied after the fact to determine if a given expenditure qualifies as Proven Costs.

- Payment of unrecovered Proven Costs will be made from revenues from future production accruing to the Federal

[3] NNPC v Famfa Oil Ltd [2012] 17 NWLR, (Pt. 1328) at page 160.

Government from the acquired participating interest.

- Interest will not be paid on the unrecovered Proven Costs.

- Disputes relating to Proven Costs must be settled through expert determination.

- To ensure the independence of the expert, the appointment of the expert will be made by the President of the Nigerian Association of Petroleum Explorationists (“**NAPE**”) or the Chairman of the Society of Petroleum Engineers (SPE-Nigeria Council).

Observations

The New Back-In Regulations will invariably impact the climate for investors in the Nigerian upstream oil and gas sector. Determination of qualifying Proven Costs is likely to generate controversies in the negotiation process and it is not completely reassuring that the selection of experts has been restricted, by the New Back-In Regulations, solely to the remit of the President of NAPE or the Chairman of the SPE-Nigeria Council. Nor is it helpful that no guidance is offered as to which of these two appointing authorities will have priority in a possible scenario where the Federal Government prefers one whilst the applicant prefers the other. Further, the restriction of the Federal Government to the defrayment of Proven Costs without the payment of interest could raise a query regarding ‘adequate and effective compensation,’ with potential implications under relevant investment treaties binding on the nation.

A key and immediate takeaway from the New Back-In Regulations is the need for licence and lease holders to keep clear and accurate records of expenditure incurred on petroleum operations whilst ensuring that such expenditure scales the WEN test from an objective standpoint. Those records may well make or break the prospects of receiving appropriate compensation should the Federal Government decide to invoke its rights under the New Back-In Regulations.

Conclusion

The issuance of the New Back-In Regulations is yet another manifestation of the Federal Government’s intention to expand the Government’s stake in the upstream petroleum sector. As the drive for additional revenue increases and the Federal Government continues to experience the negative impacts of the *COVID-19* pandemic on the economy, the pendulum action may swing the Federal Government to actively seek to exercise its rights under the New Back-In Regulations in respect of OMLs which are due for renewal and OPLs that are due for conversion. It will be interesting to watch the practical issues that may emerge in the implementation of the New Back-In Regulations whilst keenly watching over the Legislature to see if the petroleum industry bill (in its final form) will preserve the New Back-In Regulations.

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