LICENSES, LEASES AND OTHER CONTRACTUAL ARRANGEMENTS FOR THE EXPLORATION AND PRODUCTION OF PETROLEUM

A COMPARATIVE STUDY BETWEEN NIGERIA AND THE UNITED STATES

by

OMOLARA ELUMELU

(Under the direction of Professor Gabriel Wilner)

ABSTRACT

Much has been written about Oil and Gas leases. This paper focuses on the various Oil and Gas leases and other contractual arrangements for oil and gas exploration and production in Nigeria and the United States. The paper examines the origin, structure, development and mode of operations in both jurisdictions and concludes with a comparative analysis of both jurisdictions.

INDEX WORDS: Licenses, Leases, Contractual arrangements, Petroleum, Oil and Gas, Exploration, Production, Royalty.

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INTRODUCTION

Over geologic time, oil and gas were formed from decaying plant and animal matter buried in sediments within the basins of ancient seas. Oil and gas migrate through sedimentary rock until they are confined in a "trap" where they remain until disturbed.

Nigeria is a member of the Organization of Petroleum Exporting Countries (OPEC)[1] and one of the world's main oil producer and exporter[2]. As an oil and now increasingly gas producer, it has a significant potential for growth in particular in offshore activity, but petroleum production has caused tension of all sorts possibly contributing to a variety of problems ranging from political and governance instability to environmental degradation especially in the Niger Delta.

Regulating an Industry upon which the country, its government, its elites and commerce depends so exclusively, could pose a challenge. Nigeria, with a dominant tradition of common law, tempered sometimes by influences from Indigenous customs and often by regulatory, fiscal and contracting practices derived from other oil producing countries or applied by the international companies operating in Nigeria, has developed its own particular system of oil and gas (petroleum law).

This paper addresses the different aspects of the practice and the application of legislation and regulation to the practice of the Nigerian Oil and gas law and that of the United States comparing the two jurisdictions.

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[1] Organization of Petroleum Exporting Countries (OPEC) is an International Organization mad up of eleven oil-producing nations. OPEC's mission to coordinate and unify the petroleum policies of Member countries and ensure the stabilization of oil prices in order to secure an efficient economic and regular supply of petroleum to consumers, a steady income to producers and a fair return in capital to those investing in the petroleum industry. See Mana Saeed Al-Otaiba, OPEC and the Petroleum Industry http://www.opec.org/home/

[2] See Encyclopedia: Economy of Nigeria, at http://www.britannica.com/eb/article-55293/Nigeria

Chapter one analyzes the discovery of oil, the origin and development of the Nigerian oil and gas law and the evolution of state participation. Chapter two examines the structure of the Nigerian oil and gas sector and the various oil concessions operated by the multinational oil companies.

Chapter three discusses the different types of licenses and leases for the exploration and production of oil and gas and the application procedures. Chapter four examines the various types of contractual arrangements for the exploration and production of oil and gas. Chapter five analyzes the oil and gas leases in the United States and the problems associated with it. While chapter 6 gives a comparative analysis of the two jurisdictions i.e. Nigeria and the United States.

Definition of Petroleum:

Under the provision of early legislation governing Nigerian Oil and Gas exploration, Section 2 of the **Mineral Oils Ordinance[3] 1914** defined ***Petroleum*** *as "Mineral Oils, which includes bitumen, asphalt, and all other bituminous substances with the exception of coal".*

In contrast, petroleum is currently defined in both the standard Nigerian Oil Mining Lease[4] and **Section 15 of the interpretation section of the Petroleum Act[5]** as "Mineral Oil (or other related hydrocarbon) or natural gas as it exists) in its natural state in strata and **does not** include coal or bituminous shale or other stratified deposits from which oil can be extracted by destructive distillation". The expression Oil and Gas or Petroleum is used interchangeably.[6] The various statutes dealing with petroleum in Nigeria, which shall be discussed, in this paper.

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[3] Laws of the Federation of Nigeria, (1958) Cap. (120). Originally, the Mineral Oils Safety Regulations were issued under the powers granted the Governor- General of Nigeria pursuant to section 9 of the Mineral Oils Ordinance of 1914.

[4] A lease granted for the purpose of searching for, winning, working, getting, making merchantable, carrying away or disposing of mineral oils.

[5] Laws of the Federation of Nigeria, (1990) Cap. (350)

[6] The term "oil and gas" is also referred to as petroleum, this term varies from one jurisdiction to another.

STATUTES DEALING WITH PETROLEUM IN NIGERIA.

The Major statute dealing with petroleum in Nigeria is the Petroleum Act[7]. **The Petroleum Act, 1990 Laws of the Federation of Nigeria** came into force on 27 November 1969 and has undergone several amendments. The main purpose of the Petroleum Act is to vest in the State, the property in petroleum existing in its natural condition in strata in Nigeria, as well as to provide a legal framework for persons to be enabled to search for and win such petroleum.

The Oil Pipeline Act

The Oil Pipeline Act[8] came into force on October 4, 1990. It provides for the issuance of permits to survey routes for oil pipelines as well as award of licenses for the establishment and maintenance of such pipelines, incidental and supplementary to oil fields.

The Oil Terminal Dues Act 1990 Law of Nigeria

This[9] came into force on 1st January 1965. Its purpose is to provide for the levying and payment of terminal dues or any ship evacuating Oil in any terminal or any port in Nigeria.

See the judgment Committee of the Privy Council in Borys v. Canadian Pacific Railway Co (1953) A.C. 217. In Nigeria, oil and gas is usually referred to as petroleum while in the United States it is known as oil and gas.

[7] Laws of the Federation of Nigeria, (1990) Cap. (350)

[8] Laws of the Federation of Nigeria, (1990) Cap. (338), the Oil and Gas Pipeline Regulations in Statutory Instrument No. 14 of 1995, which are subsidiary legislation are geared at augmenting the Oil Pipeline Act and bringing it in line with current industry practices.

[9] Laws of the Federation of Nigeria, (1990) Cap. (339). The subsidiary legislation passed pursuant to the Oil Terminal Dues relates to the establishment of the oil terminals now in operation in Nigeria.

The Deep Offshore and Inland Basin Production Sharing Contract 1999

This[10] is the first piece of Nigerian legislation recognizing the dichotomy between, the onshore and offshore exploration regimes. This provides legislative recognition and support for the Production Sharing Contract (PSC) arrangement.

The Petroleum Profits Tax Act 1990

This[11] came into force on 1st January 1958 and whose purpose is to provide for the assessment and imposition of a tax upon the profits of enterprises engaged in the winning of petroleum in Nigeria.

The Associated Gas Re-Injection Act

This[12] came into force on 28 September 1979. It represents the only direct piece of composite Nigerian Legislation to date concerning the exploration and development of Natural Gas. Other applicable regulations are the Mineral Oils (Safety) Regulations[13], the Petroleum (Drilling and Production) Regulations[14], Crude Oil (Transportation and Shipment**)** Regulations.

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[10] This Act was passed on 23 March 1999 with retroactive effect from 1st January 1993.It provides legislative recognition and support for the production sharing contract (PSC) arrangement, which had existed and been conducted purely under contractual terms since its inception in 1973 and its substantial revision in 1993. It also modifies existing provisions (particularly royalties and duration of grants) of the Petroleum Act as well as the Petroleum Profits Tax Act for the purpose of deep water and inland basin exploration, conducted ostensibly under the PSC. The 1993 PSC was further revised in the year 2000 for the purpose of the 2000 Licensing Round, although the 1993 PSC terms remain valid between the NNPC and the contractor /oil corporations who executed them.

[11] Laws of the Federation of Nigeria, (1990) Cap. (354)

[12] Laws of the Federation of Nigeria, (1990) Cap. (26)

[13] The Mineral Oil Safety Regulations 1952 were originally under the powers granted the Governor-General of Nigeria pursuant to section 9 of the Mineral Oils Ordinance of 1914. Upon repeal of the Mineral Oils Ordinance by the Petroleum Act (Cap.350), the said regulations were deemed as having been issued under section 9 of the Petroleum Act. They were re-issued as the Mineral Oils (Safety) Regulations (1963) (effective from11 April 1962) and are currently in operation.

[14] The Petroleum (Drilling and Production) (Amendment) Regulations, (2001) introduced new fees, rents and royalty rates into the existing regulations (effective from 1 February 2000).

These regulations deal with various matters relating to search for, winning and disposal of petroleum in connection with licenses and in particular, set out model clauses, which are incorporated in such licenses[15] unless they are modified or excluded in particular cases.

[15] Apart from the Petroleum Act, such model clauses are drawn from the provisions of the Mineral Oil (Safety) Regulations and the Petroleum (Drilling and Production) Regulations

CHAPTER 1

ORIGIN AND DEVELOPMENT OF NIGERIAN OIL AND GAS LAW

1.1 Development of Nigerian Oil and Gas Law

1.2 1900-1950: Creation of Licensing Regime: Grants for the exploration of oil and gas dates from the late 19th century though municipal legislation governing such grants did not come into existence until the 20th century. In 1914, The **Mineral Oil Ordinance**[16] **No. 17** was passed and its purpose was to regulate the right to search for, win and work mineral oils. The first record of active exploration was the pioneering work in 1908 of the Nigerian Bitumen Company, its activity ceased as a result of the First World War in 1914[17].

In 1921, Oil exploration rights were granted to two British Companies namely D'Archy Exploration Company and Whitehall Petroleum Company Limited in the Niger Delta but little or no commercial activity was recorded. In 1937, the Shell D'Archy Company, a consortium of the Royal Dutch Shell Petroleum Company and the D'Archy Exploration Company commenced exploration work and were granted exclusive exploration and production rights in the whole of Nigeria. Also, the Second World War equally interrupted its exploration activity and in 1946. Upon resumption of its activities, the Shell D'Archy Company re-emerged in partnership with British Petroleum as Shell BP, assuming the position of the pioneer oil and gas exploration company in Nigeria. Exploration activity after both World Wars I & II was conducted under the

[16] Laws of the Federation of Nigeria, (1990) Cap. (120). Pursuant to section 3 of the Mineral Oils Ordinance No. 17 of 1914, there was a proviso that licenses and leases granted under any previous ordinance, particularly Ordinance No. 19 of 1909, would retain their validity. See Godfrey Etikerentse, Nigerian Petroleum Law (2d ed. 2004)

[17] The exploration activities of the Nigerian Bitumen Company, which did not result in the discovery of oil was not to continue at the end of the First World War due to its outcome and the adverse effects of the war. See Dolapo Akinrele, Nigerian Oil and Gas Law (2005)

authority of the **Mineral Oil Ordinance 1914**[18] which provided under Section 6 (1a) that *"no lease or license shall be granted except to a British subject or to a British Company registered in Great Britain or in a British Colony and having its principal place of business within her Majesty's dominions, the Chairman and the managing director (if any) and the majority of the directors of which are British Subjects***".** The effect of this provision was to fortify Shell BP's premier position over lands to which leases and licenses for the exploration of oil had been granted. The primary motive behind the passage of the legislation as a whole was to further consolidate the British influence in new economic activity in Nigeria at that time and also to avoid unrestricted competitive drilling at that time.

Again, in the United Kingdom in the 1920s and 1930s where it claimed that the search for petroleum had been unduly hampered by uncertainties as to the rights of property and having experienced similar difficulties in Nigeria, the British Colonial government secured the passage of the **Mineral Oil Ordinance in 1946**[19] whose principal purpose and effect was to vest in the Crown the property of all petroleum (mineral oils) in situ.

It provided that "*the entire property in and control of all Mineral Oil in, under or upon any lands in Nigeria and of all rivers, streams and watercourses throughout Nigeria is and shall be vested in the Crown save in so far as such rights may in any case have been limited by any express grant made before the commencement of this Ordinance*"[20]. Such vesting of rights were subject to the condition under Section 6(1b) of the Mineral Oils Ordinance 1914 that the grantee of the lease or license pay compensation to any person in lawful occupation of the land for disturbance

[18] Laws of the Federation of Nigeria , (1958) Cap.(120) See Godfrey Etikerentse, Nigerian Petroleum Law (2d ed. 2004)

[19] Laws of the Federation of Nigeria , (1958) Cap.(121)

[20] See Section 3(1), Mineral Ordinance of 1946 contained in laws of the Federation of Nigeria, (1958) Cap. (121). This provision was amended by Act No. 51 of 1968 where the expression "Mineral Oils" was deleted, confining the section to "minerals". See Mineral Act Laws of the Federal of Nigeria (1990) Cap. 226

of surface rights or as determined by the Governor–General of Nigeria. This concept till date continues to underpin the framework of Nigerian Oil and Gas law and the nature of the current compensation system has been a contributory cause for much of the conflict between the Oil producing communities[21] and the Oil corporations.

1.3 1950-1970: The Discovery of Oil:

The first commercial discovery of Oil in Nigeria was made at **Oloibiri** in Niger Delta presently known as Bayelsa State in 1965 by Shell BP who since 1937 (as Shell D'Arcy Company) had been the sole concessionaire in Nigeria. In January 1958, the first oilfield came on stream producing about 5,100 barrels per day (bpd)[22] and in the same year, section 6 (1a) of the Mineral Oils Ordinance 1914 was repealed by section 2 of the **Mineral Oils Amendment Ordinance** No. 5 1958, thus extending the grant of exploration rights to other foreign, non British corporations. Shell-BP was constrained to relinquish[23] its interests in areas of its grant in the first instance to Mobil Oil which was the first non –British entity to enter the field and thereafter in 1962, when Shell's concession area further reduced to the most promising areas and other corporations began exploration activities in Nigeria. The **Petroleum Profits Tax Ordinance 1959**[24], the last major piece of oil and gas legislation of the pre-independence era, came into

[21] As a result of the dissatisfaction of the compensation system by the Oil producing communities with the Oil Corporations, there is a constant attack of expatriates working for these Oil corporations. See Emeka Duruigbo : Managing Oil Revenues for Socio- Economic Development in Nigeria : the Case for Community-based Trust Funds, 30 N.C.J. Int'l l & Com . Reg. 121(2004)

[22] In response to the discovery of oil, the Oil Pipelines Ordinance was passed in 1956 and the Oil Terminal Dues Act Laws of the Federation Of Nigeria (1990) was passed in 1965, to meet Shell's operational requirements and levy dues for the evacuation of oil at the Bonny Terminal on the Atlantic coast of Nigeria.

[23] To let go or surrender one's interest in the Oil Lease.

[24] Laws of the Federation of Nigeria, (1959) Cap. (15) "Petroleum operations" were defined in the 1959 Ordinance and are currently defined in the Petroleum Profit Tax Act, (1990) Cap. (354) (Nigeria) as " the winning or obtaining and transportation of petroleum or chargeable oil in Nigeria by or on behalf of a company for its own account by any drilling, mining, extracting or other like operations .

force in 1958, introducing a 50 percent tax on chargeable profits from petroleum operations[25], thus giving the Government a share indirectly, in the profits from petroleum activities.

As the new multinationals began to increase, their exploration activity in the 1960s, the Nigerian Government sought to increase its level of involvement in oil and gas exploration. Initially, it had been involved as an observer in the liberations of OPEC since 1964 and in agreement with the resolution of the United Nations had sought steadily to increase its control over oil production. This was further hastened by the increase in exploration and production activity in the decade of the 1960s. It was later realized that Mineral Oils ordinance of 1914 was no longer adequate in regulating Oil and Gas activity and this led to the promulgation of the **Petroleum Act in 1969**, which repealed the Minerals Oil Ordinance of 1914 whilst preserving the validity of licenses and leases issued under the said Mineral Oils Ordinance.

The Petroleum Act was pronounced in Section 1(1) that "*the entire ownership and control of all petroleum in, under and upon any lands to which this section applies shall be vested in the State*"**.** This provision coupled with section 2(2), which provided that "*licenses or leases may be granted only to citizens of Nigeria or companies incorporated in Nigeria under the Companies Act fully subordinated exploration and production activity as well as the entities engaged in it under Nigerian Legislative Authority*".

[25] "Petroleum Operations" were defined in the 1959 Ordinance and are currently defined in the Petroleum Profit Tax Act Laws of the Federation of Nigeria (1990) Cap. (354) as," the winning or obtaining and transportation of petroleum or chargeable oil in Nigeria by or on behalf of a company for its own account by any drilling , mining, extracting or other like operations or process, not including refining at a refinery, in the course of business carried on by the company engaged in such operation, and all operations incidental thereto and sale of or any disposal of chargeable oil by or on behalf of the company.
See Yinka Omoregbe: The Legal Framework for the Production of Petroleum in Nigeria , 5 J. Energy L. 273 (1987)

The 1969 Act also known as the Petroleum Act for the first time in the Nigerian Oil and Gas sector established a comprehensive statutory regime for the grant of rights to search for and win oil in Nigeria and remains the basis for the regulatory system in operation today.

1.4 1970 –1990- Evolution of State Participation.

In 1971, Nigeria became a member of the OPEC and in line with OPEC resolutions passed in late 1960s immediately started increasing both its control over the degree of competition within the Nigerian petroleum sector. The rapid rise of oil production revenues in the 1970s (**the "Oil Boom Era"**) hastened the realization of the government policy of implementing OPEC resolutions calling on Member States to participate more actively in oil operations and this in turn led to the establishment of the **Nigerian National Oil Corporation Act 1971 (NNOC)**.

The NNOC operated alongside the **Ministry of Petroleum Resources**[26] (MPR) with separate and distinct functions. The MPR continued the functions of the Department of Petroleum Resources (DPR) as regulator of petroleum operations of the oil corporations, while the NNOC in 1971 commenced the process of the acquisition of the assets and liabilities of the existing foreign oil corporations on behalf of the Nigerian Government.

The **Nigerian National Petroleum Corporation**[27] (NNPC) came into existence on 1st April 1977 embodying a merger between the NNOC and the MPR and the NNPC fully succeeded the NNOC in all aspects[28], assimilating the Ministry of Petroleum Resources regulatory functions under the Petroleum Inspectorate Department.

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[26] In 1975, the Petroleum Resources Department became the Ministry of Petroleum Resources. See Yinka Omoregbe: The Legal Framework for the Production of Petroleum in Nigeria , 5 J. Energy L. 273 (1987)

[27] See section 5 of the Nigerian National Petroleum Corporation Act, (1990) Cap. 320, Laws of the Federation of Nigeria.

[28] See the Nigerian National Petroleum Corporation (NNPC) Act, Laws of the Federation of Nigeria (1990) Cap. 320, See also Part B of the Second Schedule to the NNPC Act Cap. 320, pursuant to which

In 1979, the NNPC completed the process of acquisition of the majority interests[29] in the operations of the oil corporations then engaged in exploration and production in Nigeria, which up until then were 100 percent wholly owned by those corporations. NNPC acquired participation interest in the petroleum operations as opposed to the equity holdings within those corporations. Such acquisitions resulted in the creation of what is called the **"The Traditional Joint Venture (TJV)**"[30] as it presently exists in the oil and gas sector. The acquisition of each interest was to be formalized by the simultaneous signing of Heads of Agreement with Participation Agreements and thereafter, the Joint Operating Agreements**.**

NNPC's Participation Interest in Traditional Joint Ventures.

NNPC/AGIP/PHILIPS OIL: NNPC-60%, ENI/AGIP-20%, CONOCOPHILLIPS-20%, (NAOC-Nigeria Agip Oil Company is the Operator of the Joint Venture).

NNPC/SHELL PETROLEUM DEVELOPMENT COMPANY (SPDC): NNPC-55%,

Shell -30%, ELF–10%, Agip –5 %(Shell is the Operator of the Joint Venture).

NNPC/MOBIL PRODUCING NIGERIA LIMITED –NNPC 60%, Exxon Mobil –40%

(Mobil is the Operator of the Joint Venture).

NNPC/CHEVRON NIGERIA LIMITED: NNPC – 60%, Chevron Texaco- 40%

(Chevron is the Operator of the Joint Venture).

NNPC / ELF PETROLEUM NIGERIA LIMITED (EPNL) – NNPC 60%, ELF –40 %(Elf is the Operator of the Joint Venture).

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all employees, assets and liabilities of the dissolved NNOC were vested in NNPC. An important part of the assets were the rights under Government Notice No. 311 in Gazette No. 59 of February 1972, pursuant to which the Government reserved all open acreages for the NNOC.

[29] Also known as the participating interest. The Participating Agreement, the precursor to the Joint Operating Agreement addresses issues such as the percentage ratios of participation interests in the Oil Mining leases and assets, the consideration paid by the Government to the oil corporation and the stipulation that the Joint Operating Agreement be signed by the parties within a reasonable time thereafter.

[30] Id at 29.

NNPC/TEXACO OVERSEAS PETROLEUM COMPANY NIGERIA LIMITED (TOPCON)-NNPC 60%, Chevron Texaco 40 %(Texaco is the Operator of the Joint Venture).

NNPC/PAN OCEAN OIL LTD: This Joint Venture has now been converted into a Production Sharing Contract (PSC) arrangement between NNPC and Pan Ocean Oil Limited.

In 1986, the Petroleum Inspectorate responsible for regulation and policy formulation was detached from the NNPC and re-created as the Department of Petroleum Resources (DPR).

The NNPC was then left to engage in the commercial aspects of Oil and Gas activity through the National Petroleum Investment Management Services (NAPIMS). These Activities are conducted mainly on the basis of the Traditional Joint Venture Arrangements concluded between the NNOC and the foreign multinational oil corporations which currently operate in Nigeria through a variety of locally registered subsidiary companies usually linked to a specific project or operational function. NAPIMS, on behalf of the Government controls a majority of stake in the Six Traditional Joint Venture operations with the Nigerian subsidiaries of the Royal Dutch Shell Group, ExxonMobil, Chevron, Texaco, Eni/Agip and TotalfinaElf (now TOTAL) which account for majority of Nigeria’s total production with Shell’s Traditional Joint Venture currently being the largest of the joint venture operations.

The Oil corporations, which have undergone worldwide mergers over the past decade, continue to discharge functions as partner to the NNPC and Operator of the Joint Venture through the corporate entities, which existed before the mergers occurred.

All decisions are taken through their management, and all operating costs of each joint venture partners are financed jointly between Joint Venture partners in accordance with their equity interests by a system of monthly cash call[31] in line with their current levels of equity interests.

[31] Payment made to NNPC by each multinational oil corporation. See Yinka Omoregbe, The Oil and Gas Industry: Exploration and Production Contracts (1997)

The Contractual relationship between the NNPC and the joint venture partners is subject to a **Memorandum of Understanding**[32] (MOU), designed to provide attractive fiscal incentives to the participating oil corporations in exchange for increased investment and efficient operations.

The MOU is subject to regular review in order to adjust to the ruling cost production and oil price regimes. The operational basis for the JV and the MOU is the Joint Operating Agreement (JOA), which designates the operator of the joint venture, specifies each partner's share in the cost of petroleum operations indicates Petroleum Profit Tax and royalty obligations and outlines various commercial principles among other considerations. The JOA permits the NNPC to reserve the right to become the operator in any joint venture undertaking however, a lack of sufficient indigenous expertise and more importantly financing continues to date to constitute an impediment to the realization of such a right. With most of the major oil and gas projects focusing on the joint venture operations in which NNPC is the major shareholder, matters of joint venture funding and cash calls continue to be of paramount concern to State Participation policy within the sector.

[32] This is a legal document describing a bilateral agreement between parties, indicating an intended common line of action, rather than a legal commitment, a more formal alternative to a gentleman's agreement but generally lacks the binding power of a contract.

CHAPTER 2

CURRENT STRUCTURE OF THE NIGERIAN OIL AND GAS SECTOR

2.1 1990s to the Present: The Movement Offshore, Modification of State Participation and Indigenization.

All oil production has to date occurred in the Niger Delta Basin. The developments of three Dimensional (3D) seismology and deep drilling technology have made the deep sea a very attractive proposition for oil exploration. It was in response to this overwhelming potential that the Nigerian offshore exploration, deepwater development program commenced through the 1990/1991 **Licensing Round**[33]. The Government, which had already begun re-evaluating its involvement in its Traditional Joint Ventures offered for bidding, a number of new concessions in the deep outer shelf of the Niger Delta area.

In 1993, deep offshore blocks in water depths between 200m-3000m were awarded to foreign oil corporations including Royal Dutch Shell, Chevron Texaco, Exxon Mobil, TotalFinaelf, and EniAgip who were mandated to incorporate new subsidiary entities[34] under the Production Sharing Contract (PSC) arrangement. Such contractual arrangements have since become the contractual vehicle of choice between the NNPC and oil corporations for offshore exploration and production of oil and gas.

In March 2000, the federal government opened competitive bidding on 22 new oil blocks including 11 in the Niger Delta deep and ultra-deep offshore in which 46 oil companies participated. In 2005, the federal government made available 63 oil blocks.

[33] Licensing Round is a bidding opportunity for the oil corporations to bid for oil blocks or concessions.
[34] Further to this mandate, eight subsidiary entities for TOTAL namely Total E &P Deepwater A-H were incorporated at the Corporate Affairs Registry, Nigeria by Ms.Omolara Elumelu.

The emergence of the offshore regime also resulted in the entrance of new foreign oil corporations into Nigeria, including Exxon (prior to its merger with Mobil) now Exxon Mobil, Conoco (now Conoco-Phillips), Canadian Occidental (now Nexen Petroleum) Statoil/British Petroleum Alliance, Jerez Energy, Marathon Oil, Trans Atlantic Petroleum Corporation, Ocean Energy, as well as BP Amoco which had until the latter part of the 1990s also had been involved but subsequently withdrew its interests in the country. However, notwithstanding the current dominance of onshore/shallow water exploration and production to date, new discoveries continue to be made.

Since the beginning of the offshore exploration and development campaign in 1995, a number of sizeable discoveries have been made in the offshore area. The major commercial fields are Erha[35] (OPL 209), Bonga [36](OPL 212), Agbami[37] (OPL 216) and Akpo[38] (OPL 246).

2.2 Erha OPL 209

This field belongs to Exxon Mobil; it was discovered in 1999. Production of oil is through the utilization of the Floating, Production, Storage and Offloading (FPSO) vessel. Exxon Mobil holds a majority interest and operates OPL 209 under a Production Sharing Contract (PSC) with the NNPC; Shell is Exxon Mobil's Partner in OPL 209.

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[35] Operated by ExxonMobil. See Dolapo Akinrele, Nigerian Oil and Gas Law (2005).

[36] Operated by Shell. See Yinka Omoregbe,: The Prevailing Situation in the World Oil Industry, its effect on Production Contracts and Developing Countries Economies 2 OGLTR 40 (1989)

[37] Operated by Chevron Texaco, presently known as Chevron Nigeria Limited. See Derek Fee, the Oil and Gas Databook for Developing Countries(2d ed. 2004)

[38] Operated by Elf Petroleum Nigeria Limited presently known as TOTAL. See Louis Turner, Oil Companies in the International System (3 Rev. ed. 1983)

2.3 Agbami OPL 216

This field belongs to Chevron Texaco; Chevron discovered the Agbami field through the drilling of a wildcat well in November 2001.Chevron's affiliates; Star Deepwater Petroleum Limited and its partners signed a 30year PSC with NNPC, which will entitle NNPC to a 40% interest upon conversion of the Oil Prospecting License to an Oil Mining Lease. Oil production, utilizing a FPSO began in 2006.The majority of the Agbami Field lies in OPL 216; Star Deepwater Petroleum Limited's partners are Famfa Oil and Petrobas.

2.4 Bonga OPL 212 (OML 118)

In May 2001, Shell announced the Bonga deepwater development discovery, which came on stream in 2004. Shell is the major operator with its majority interest and partners and its partners are ExxonMobil, Eni/Agip and Totalfinaelf.

2.5 Akpo OPL 246

Totalfinaelf announced the AKPO discovery on OPL 246 in May 2000. Totalfinaelf is the operator and its partners are South Atlantic Petroleum with a majority interest in the OPL and Petrobras. The AKPO field is very near the boundary of the Joint Development Zone (JDZ), which was recently established between Nigeria, Sao Tome and Principe.

2.6 Licensing Round

The Nigerian Government held a special licensing round to offer marginal fields to local firms and in June 2002, pre-qualified 71companies out of 150 that submitted bids. The purpose of the licensing round was to allow for more participation by indigenous oil companies in Nigeria's upstream oil exploration and production activities. Twenty-four Marginal fields[39], which had been relinquished[40] by Shell, Chevron Texaco, and Totalfinaelf were distributed to 31 of the 71 companies pre-qualified prior to the licensing round.

The Government identified about 116 fields in the Niger Delta, which it categorized as **"marginal"**[41], located within existing OMLs, which according to the Government has substantial collective reserves and has not been developed under the TJV arrangements between the multinational oil corporations and the NNPC. These were proposed for allocation in future marginal field licensing rounds.

The indigenous oil companies are essentially sole risk operators and enter into partnerships either of the nature of a PSC or joint venture relationship with foreign oil corporations. Production caps imposed on indigenous producers to ensure the OPEC quotas are not exceeded, makes it clear that indigenous operators are more at risk and more vulnerable than the multinational oil corporations to oil production policies.

2.7 Impact of Environmental Protection Laws

The risk of pollution and environmental degradation are inevitable results of oil exploration and production. Oil exploration and production operations were subject to several Oil spills on various scales between mid 1970 and late 1990. The effect of flaring natural gas, which the Government now seeks to curtail and eliminate, has also added significantly to the environmental threats through the emission of vast quantities of green house gases and deforestation.

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[39]An oil field initially leased to an oil corporation but which is designated by the Federal Government as such, as a result of its non-development but has substantial oil.

[40] Oil companies were made to surrender these oilfields back to the Federal Government as a result its non-development.

[41] Id. at 39.

The Petroleum Act (particularly the Petroleum Drilling and Production Regulations[42]) led to the adoption of statutes mandating that the oil exploration license, oil prospecting license and oil mining lease, adopt all practicable precautions to prevent the pollution off inland waters, rivers and water courses, the territorial waters of Nigeria or the high seas by oil, where any such pollution has occurred to take prompt steps to control or end it. Some of these provisions lack specific enforcement mechanisms particularly as the bulk of oil production in Nigeria is on Land. **The Harmful Waste Act**[43] was passed on November 25, 1988 to provide a framework for the effective control of toxic and hazardous waste into any environment within the confines of Nigeria. Also, **Federal Environmental Protection Agency Act**[44] **(FEPA)** was passed on December 30 1988, which is responsible for the protection and development of the environment in general and environmental technology. It also advises the government on environmental policy and establishes environmental criteria, guidelines, or specific action or standards for the protection of the nation's air and water so as to protect the welfare of the population from environmental degradation. The Department of Petroleum Resources (DPR), which is responsible for regulating and supervising all activities, connected with petroleum exploration and exploitation realized that the exploration of the oil resources has a serious environmental impact; and decided to set out comprehensive standards and guidelines to direct the execution of projects with proper consideration for the environment. The Department of Petroleum's **EGASPIN**[45] **(Environmental Guidelines and Standards for the Petroleum Industry in Nigeria)** which was issued in 1991 and updated in 2002 is a comprehensive working document

[42] Laws of the Federation of Nigeria, (1990) Cap. (350)
[43] It is generally referred to as Harmful Waste (Special Criminal Provisions) Act, (1990) Cap. 165 Laws of the Federation of Nigeria. See Godfrey Etikerentse, Nigerian Petroleum Law (2d ed. 2004)
[44] Laws of the Federation of Nigeria, (1990) Cap. (131). Its motive is to provide a framework for the effective control of toxic and hazardous wastes into any environment within the confines of Nigeria.
[45] A document released by the Department of Petroleum Resources for the protection of the environment.

which gives serious consideration to the preservation and protection of the Niger Delta and is a mandatory compliance tool for the greater part of oil exploration and production activities.

CHAPTER 3

THE LICENSING OF OIL AND GAS EXPLORATION AND PRODUCTION

3.1 Legal Basis for Licensing

The Petroleum Act sets out the legal framework for persons to be enabled to search for and win petroleum. The scope of such rights from land to the continental shelf and exclusive economic zone is provided for under the **Petroleum Act**[46] and the **Constitution of the Federal Republic of Nigeria 1999**[47]. The Petroleum Act also empowers the Minister to grant to such persons as he thinks fit, licenses and leases to explore, prospect, search for, win and carry away and dispose of petroleum.

Public control of petroleum exploration and production is achieved by vesting in the Minister the discretion whether to grant licenses as to their consideration as well as their terms and conditions. **Section 2 (1) of the Petroleum Act** provides that subject to this Act, **the Minister** may grant-

i) A license, to be known as an **oil exploration license** [48] to explore for petroleum;

ii) A license, to be known as an **oil-prospecting license** [49] to prospect for petroleum;

iii) A lease to be known as the **oil mining lease**[50] to search for win, work, carry away and dispose of petroleum.

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[46] Laws of the Federation of Nigeria, (1990) Cap. (350)
[47]See Section 1 of the Petroleum Act, Cap. (350) and Section 44(3) of the Constitution of the federal Republic of Nigeria 1999. A legal document, which is binding on the country of Nigeria and its citizens and its operations as a whole, the revised version being the 1999 Constitution.
[48] A lease or permit to explore for petroleum.
[49] A lease or permit to prospect for petroleum.
[50] A lease or permit to search for, win, work, carry away and dispose of petroleum.
See generally, Energy Law Proceedings of the Advanced Seminar on Petroleum, Minerals, and Energy Resources law organized by the International Bar Association Section on Energy and Natural Resources Laws, (1988)

Section 2 (2) of the Petroleum Act states that "a license or lease under this section may be granted only to (a) a citizen of Nigeria or (b) a company incorporated in Nigeria under the Companies and Allied Matters Act (CAMA) or any corresponding law." The state having been vested with the entire ownership or control of all petroleum in accordance with Section 1 of the Petroleum Act, was and is at liberty to decide how petroleum is to be exploited or even whether it should be exploited at all. The state could therefore undertake exploration and production itself, through a wholly owned entity of the State or by joint venture or by employing oil companies as contractors either through Production Sharing Contracts (PSC) or through Service Contracts (SC), to get the oil on its behalf.

Therefore, anyone who seeks to explore for petroleum through another means other than under a license or contractual grant by the State is interfering with the property rights of the State. The PSC[51] pursuant to the 2000 licensing round were executed between the contractor oil corporations, the NNPC a holder and the Federal Government, which was represented by the Ministry of Petroleum Resources (MPR).

3.2 Process of Award of Licenses

The Process of Award has been described as the identification by Government of potential upstream petroleum investment opportunities in the national territory, their subdivision into discreet contract areas of prospective size, their offering to the international oil companies by a suitable tendering process and the establishment and negotiation of technical financial and contractual terms and conditions (for award) consistent with their petroleum prospectivity and

[51] Production Sharing Contract. See the principle established in African Insurance v. Fantaye (1986) 3 N.W.L.R (Pt 32) at 811.

with the national interest[52]. The License serves to establish the rights of the licensee in substances produced from the licensed area and to regulate the manner in which operations under the license are conducted. It also provides an instrument of governance for direction of exploration efforts into particular areas and for the control of the rate of depletion of resources.

Licenses are issued under the **Petroleum (Drilling and Production) Regulations**[53], which the Minister is empowered to make by virtue of **Section 9 of the Petroleum Act**[54]. These regulations lay down conditions for application of licenses.

The Invitation for applicants in a licensing round is provided for by way of guidelines or guidance notes for the particular bidding or licensing round, which lists the blocks on offer and indicates application procedures.

3.3. Discretionary Licensing

This is an informal system of licensing whereby the government may or may not define the specific acreage for licensing and the multinational oil corporation approaches the government by application and the license is granted. (As the name depicts, this is strictly based on the discretion of the Federal government).

This practice under the Petroleum Act has been for the State to make discretionary allocations to entrepreneurial multinational oil corporations who are armed with technical knowledge, either from activities through Oil Exploration License (OEL) or from third party sources, approach the

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[52] See Michael A.G Bunter, The Promotion and Licensing of Petroleum Acreage (Klumer Law International) 379 (2001)

[53] This provides that every application for an OEL, OPL and OML shall be made to the Minister of Petroleum resources in a prescribed form. See Regulation 1 of the Petroleum (Drilling and Production) Regulations and Form A, in the Schedule to the Regulations. See also Abioye v. Yakubu (1991) 5N.W.L.R (Pt 190) 130

[54] Laws of the Federation of Nigeria, (1990) Cap. (350)

government for a discretionary award of license. This system though progressively less utilized in the Nigerian Sector over the past ten years still remains recognized by regulation. This process has the attitude of selectivity in prospective licensees, minimized costs and bureaucracy, however it is bedeviled with disadvantages such as the inability of the government properly to evaluate the fair market value of petroleum acreages, a lack of transparency and its attendant effects including arbitrariness in allocation of acreages as well as inability of the government to attract truly competitive offers from multinational corporations.

3.4 Application Process for Oil Exploration License, Oil Prospecting License and Oil Mining Lease**.**

The Petroleum Drilling and Production Regulations provides that every application for an Oil exploration license, Oil prospecting license and an Oil mining lease, shall be made to the Minister of Petroleum Resources in a prescribed form, the applications are accompanied by payment of fees, requisite copies of maps on scales specified by the Department of Petroleum Resources with delineation of the boundaries of the area in which the application is made; with an adequate survey description of the boundaries, evidence of financial status and technical competence of the applicant, details of work program, details of annual expenditure, commencement of operations, scheme of recruitment and training of Nigerians, evidence of applicant's ability to market the petroleum produced, annual reports in respect of the applicant's oil exploration and production activities in the preceding three years. Any other relevant information which the Minister may call for by notice in the Federal Gazette or otherwise.

Applications for an OEL[55], OPL[56] or OML[57] can be withdrawn by notification in writing and the Minister shall accept it once the prescribed fee has been paid.

3.5 Licensing by Auction or Licensing Round

The licensing of petroleum activity by auction is a recent development in Nigeria. It is a bidding process often associated with an active promotional campaign and open system which employs several bidding methods such as sealed bid often with the retention of a reserve price as a floor to protect against a "ring" and "under bidding" as well as an open auction system[58].

Under this system, the state receives a fair market value for its petroleum acreage with the multinational oil or indigenous company having paid a substantial signature bonus for exploration and production rights over the period of grant.

The guidance notes, which accompany the auction system, also prescribes that the licensee will carry out an adequate work program and this commitment is further reinforced by the signature bonus.

3.6 Types of License under Petroleum Act

The term "**License**[59]" according to the black's law dictionary is defined as permission or a document or certificate evidencing such permission.

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[55] See Paragraph 1 of the First Schedule of the Petroleum Act, (1990) Cap. (350) (Nigeria)

[56] See Paragraphs 5 and 6 of the First Schedule to the Petroleum Act, 1990 Cap. (350) (Nigeria)

[57] See Paragraphs 8-1 of the First Schedule to the Petroleum Act, 1990 Cap. (350) (Nigeria)

[58] The First ever Licensing Round conducted in Nigeria was on 26 February 1970, when the Nigerian Government announced open bidding for 27 offshore acreages of which 12 were reserved for the proposed Nigerian National Oil Corporation which was then established in 1972. See Godfrey Etikerentse, Nigerian Petroleum Law (2d ed. 2004)

[59] See Regulations 12 of the Petroleum (Drilling and Production) Regulations, Laws of the Federation of Nigeria, (1990) Cap. (350)

3.6.1 Oil Exploration License

Oil Exploration License[60] (OEL) is usually granted by the Minister in respect of an area of undetermined prospect on which the Minister has not placed a premium. The license confers upon the licensee, non-exclusive rights subject to the surface rights of the owners or occupiers (e.g. communities) of the area of license to explore for petroleum by geological and geophysical means. The Oil Exploration License permits the licensee to erect temporary structures necessary for operations which may thereafter be dismantled and removed and does not preclude the grant of another Oil exploration, prospecting license or Oil mining lease over part or whole of the same area.

The Oil Exploration License terminates on December 31 following the date on which it was granted which means that its initial lifespan cannot in any circumstance exceed one (1) year. Application for renewal must be made at least three months before the expiry of the OEL (for one more year) subject to the fulfillment of obligations contained in the model clauses, which are deemed to be incorporated into the Oil Exploration License by operation of law.

Such obligations include the commencement of work within three months of the grant of the Oil Exploration License and the satisfactory prosecution of same, the rendering of reports to the DPR[61] particularly on any hydrocarbons or other economic minerals discovered in the area of grant as well as final report incorporating all relevant documents such as data and maps on the work done on the relevant area within two months of the expiration of the license. Under the Oil

[60] See paragraph 1 of the First Schedule to the Petroleum Act, Laws of the Federation of Nigeria, (1990) Cap. (350) See Michael Turner: Oil Exploration Strategies for Developing Countries, 2 Nat. Resources J. 319 (1987)

[61] The Department of Petroleum Resources is an arm of the Ministry of Petroleum, which deals with the application procedure for the various oil licenses and leases in Nigeria.

Exploration License, the government has proprietary rights to the data gathered by the licensee during the life of the OEL.

The present practice is that the State engages the services of a seismic data gathering Service Company and such seismic information is available for perusal by oil companies from the Department of Petroleum Resources upon payment of fees.

3.6.2 Oil Prospecting License.

The Oil Prospecting License [62] (OPL) conveys an exclusive right to explore and prospect for petroleum within the area of license. The Duration of an OPL is five (5) years including renewals and the grantee is entitled to carry away and dispose of petroleum won during prospecting operations subject to fulfillment of special terms imposed under the Petroleum Act (which includes government's right to participate in the venture to which the license relates).

3.6.3 Oil Mining Lease

The Oil Mining Lease[63] (OML) is granted to the holder of an OPL who has

i) satisfied conditions imposed on the license or otherwise on him by the Petroleum Act

ii) discovered oil in commercial quantities**.** Oil is deemed to be discovered in commercial quantities by the OPL holder if the Minister is satisfied with the licensee's evidence that the licensee is capable of producing at least 10,000 barrels per day (bpd) of crude oil from the licensed area i.e. from the OPL area**.**

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[62] See paragraph 5 and 6 of the First Schedule to the Petroleum Act, Laws of the Federation of Nigeria, (1990) Cap. (350)

[63] See paragraphs 8-13 of the First Schedule to the Petroleum Act Cap. 350

The OML is an exclusive right within the leased area to conduct exploration and prospecting operations and to win and get, work store, carry away petroleum in or under the leased area. The term of the OML shall not exceed 20 years but may be renewed under the Act.[64]

The OML is also subject to the rights of the Federal Government to participate in the venture to which the license relates. The OML shall be subject to compulsory relinquishment[65] of one half of the lease area, ten (10) years after the grant. However, OMLs, which have been renewed, will not be subject to relinquishment. Applications for renewal must be made not less than 12 months before the expiration of the lease in respect of a whole or part of the lease.

3.7 General Provisions governing Licenses and Leases

Areas of Grant: boundaries applied for shall be in north to south and east to west directions and coincide with all or part of existing license boundaries or international or interstate boundaries with grid lines as designated by the Minister. For example, 5000 sq miles for an OEL, 1000sq miles for an OPL and 500sq miles for an OML.

The OEL, OPL AND OML are subject to the law of the state in which they are situated, registrable and upon registration, the document counterpart is forwarded to the Director of Petroleum Resources (e.g. In Rivers State of Nigeria[66], the communities within the state demand for a lot of amenities, cash and infrastructure in exchange for the Oil which the Oil corporations get from their community).

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[64] See paragraphs 8-13 of the First Schedule of the Petroleum Act, Laws of the Federation of Nigeria, (1990) Cap. (350)

[65] Relinquishment here refers to abandonment of a right, i.e. the right of the OML holder over that particular area. See Keith Blinn, Cluase Duval, Honore Le Leuch, Andre Pertuzio, International Petroleum Exploration and Exploitation Agreements 26 Int'l l & Comp. L.Q.2 (1987)

[66] A major oil producing state in Nigeria with host communities requesting for amenities in exchange for the oil explored and produced from their communities.

Form: The OEL, OPL AND OML are issued in a prescribed form as provided in the regulation[67].

Publication: All grants or renewals of OPLs and OMLs as well as surrenders, determinations, or assignments are published in the Federal Gazette with the name of the Licensee or Lessee and the situation of the relevant area[68]. The Petroleum Regulations makes provision for the powers and the general rights of the licensee such as the right and general power to prospect search for and win the petroleum in the relevant area of grant and the restrictions on the licensee. Work obligations and conduct of operations under the license particularly field development, abandonment and environmental obligations, compliance with health and safety regulations.

Termination: When the license or lease comes to an end by effluxion of time or surrender by the licensee or lessee of the whole or part of the relevant area. This is also the expiration of a lease term resulting from the passage of time rather than from a specific action or event; payment of fees and royalties.

3.8 Salient Issues relating Oil Prospecting Licenses and Oil Mining Leases.

The issue arises particularly in the context of the relinquishment provisions under paragraph 12 (1) of the First Schedule to the Petroleum Act, which provides that *"ten (10) years after the grant of an OML, one half of the area of the lease shall be relinquished"*. The liberal construction of the Transitional and Savings provisions is that, as the term granted is preserved, the scope of the grant cannot be altered during such a term and therefore the requirement of relinquishment of one half of the license cannot be enforced. However on a strict construction of the Transitional and Savings provisions, the unexpired term granted under the Pre-1969 license is preserved simpliciter except for rents and royalties. In any case the pre-1969 leases must be

[67] See Regulations 10 and 14 of the Petroleum (Drilling and Production) Regulations.
[68] Id at 67

subordinated to the provisions of the Petroleum Act. Though there are arguments in support of both competing views, but this issue has not yet been the subject adjudication by Nigerian Courts, probably because of the working relationships between the operators and the regulatory authorities but may also be the fact that the Minister's discretion under the Transitional and Savings provisions can be applied on a case by case basis should any dispute arise.

3.8.1 Assignment:

The Assignment of an OML or any interest, right or power derived from it[69], is prohibited without the consent of the Minister of Petroleum Resources. Application for an assignment is accompanied by the payment of prescribed fees[70]; which could be waived by the Minister in certain cases. The decision to grant or refuse the assignment is entirely discretionary and in exercising this discretion, the Minister must be satisfied that the assignee is of good reputation, has access to technical expertise, knowledge, experience and funding to continue the work program and in all respects acceptable to the Government[71].

3.8.2 The State's Right of Pre-emption and special conditions imposed on the Licensee and the Lessee:

According to **Section 7 of the Petroleum Act**, "*the pre-emption right of a state may be the occurrence of a natural emergency or war giving the Minister the authority to exercise such pre-emption rights. The Minister can also exercise his discretion to advise the President to declare a state of emergency where as a result of low availability of petroleum or petroleum products,*

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[69] An example of such a right, power or interest is an Oil Pipeline license, which is held and operated under the Oil Pipeline Act Laws of the Federation of Nigeria (1990) Cap. (338)
[70] See Regulation 58 of the Petroleum (Drilling and Production) Regulations
[71] There are conditions to be complied with before the Minister exercises his discretion. See the Petroleum Act, Laws of the Federation of Nigeria (1990) Cap. (350)

there is an actual breakdown or a clear and present danger of actual breakdown of public order or safety." The Minister may impose special terms on a license or lease including terms and conditions as to the Federal Government participation in the venture to which the license or lease relates on negotiated terms.

3.8.3 Revocation

The Oil license or lease may be revoked if the licensee or lessee becomes controlled directly or indirectly by a citizen of subject or a company incorporated in a country other than the licensee or lessee's country of origin or a country whose laws do not permit Nigerian citizens or Nigerian companies to acquire hold and operate petroleum concessions on conditions which in the opinion of the Minister are reasonably comparable with those applicable to subjects of that country. Another ground for revocation is when the Minister is of the opinion that the licensee or lessee is not conducting operations vigorously and in accordance with good oil fields practice and fails to comply with any provision of the Petroleum Act and special conditions of the licenses and lease or fails to pay rents or royalties as at when due under the Act or fails to furnish reports on his operations as the Minister may lawfully require.

Prior to the revocation, the licensee or lessee is informed and given the opportunity to explain and rectify the breach within a specified period. If no satisfactory explanation is made or the breach is not rectified, the license or lease shall be revoked. One has to bear in mind that in Nigeria, the Minister is endowed with a wide discretion of powers.

3.8.4 The Proper Law of Licenses and Leases.

Notwithstanding the contractual form of license, neither its provisions nor its model clauses contain an express choice of governing law. In this regard, we must refer to the common law conflicts relating to the governing law of contracts. The proper law doctrine provides that where the parties have not given expression to the intention that the law of a given country will govern the contract, then the intention may be inferred from the contract itself or from surrounding circumstances and this inference will determine the proper law. Factors, which support this inference, include the nature of the contract, customs of business, the ***lex loci contractus***[72] and the ***lex loci solutionis***[73] i.e. the law most closely connected with the contract. Therefore the formation, the validity of the contract, its interpretation and its discharge are all governed by the same law, which therefore applies to the creation as well as to the performance of the contract. Therefore in the context of licenses and leases where all the parties have to perform their contractual obligations in Nigeria, it is very likely that the court will find that the Nigerian Legal system is the one which the contract is most closely connected[74]. The convergence in the context of the license and lease of the ***lex loci contractus*** and ***lex loci solutionis*** clearly confirms the proper law of license and lease as Nigerian law.

Arbitration

Section 11 of the Petroleum Act provides that "*where provisions of the Act or the regulations subsidiary to the Act provide that the questions or disputes are to be settled by arbitration*[75]*. It*

[72]Where the contract is made.
[73] Where the contract is performed.
[74] See Chatenay v. Brazilian Submarine Telegram Co. 91891) 1 QB 79 For Principle that importance and weight will be attached to the lex loci solutionis. The Assunzione (1954) 1 W.L.R 150 at 178, 184.
[75] Arbitration is a means of settling disputes under the Alternative Dispute resolution. (ADR), it is time saving and faster than litigation and mostly preferred by multinational oil corporations. The Arbitration and Conciliation Act Cap. (19) is applicable to the Federal Capital Territory, most states have enacted their own arbitration laws i.e the Arbitration law of Lagos State. Where the appropriate state (chosen by

shall be the arbitration law of the appropriate state that will apply". The appropriate state in this context is defined as the state agreed by the parties and where no such agreement is reached; the arbitration law of the Federal Capital Territory (FCT) Abuja shall be applicable.

Paragraph 41 of the First Schedule to the Petroleum Act equally provides that *"any dispute arising in connection with any license or lease between the Minister and the licensee or lessee including payments of fees, rents or royalty will be settled by Arbitration unless the matter is expressly excluded from arbitration or expressed to be at the discretion of the Minister".* Arbitration shall not apply to matters that are precluded from arbitration under the Act nor acts of Ministerial discretion.

3.9 Amendments of Licenses and Leases

The Licenses and Leases being in the form of a contract between the Minister and the licensee cannot be unilaterally amended by either party except where such an amendment is expressly authorized by both sides or effected by amendment to the Petroleum Act or the Petroleum Drilling and Production Regulations. Amendments[76] to individual leases may also be effected through the renewals of the lease upon its expiry**.**

3.10 Nature of Interest created by Licenses and Leases under the Petroleum Act.

The Nigerian Petroleum license is contractual in form, being executed by the Minister and the Oil companies as parties. It involves the transfer of rights in consideration for annual payments

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the parties) has no arbitration law, it must be deemed that no agreement has been reached and the Federal Capital Territory is thus applicable.

[76] See for example the amendment to regulation 58 in the Petroleum (Drilling and Production) Regulations Statutory Instrument No. 3 of 2001 introducing, new fees, rents and royalties. In practice, the Minister makes prior consultation with oil sector stakeholders before decisions are made amending regulations to the prejudice if the license or leaseholder. See Also Amodu Tijani v. Secretary of Southern Nigeria (1921) A.C 339

and royalties but through the application of the Petroleum Act and the incorporation of model clauses, it retains a strong regulatory element.

The dual identity is also to be found in France, USA, Canada and Norway where divisions are made between petroleum licenses and license regulations. Therefore the rights bestowed on Nigerian grantees include proprietary interests in the petroleum in situ, subject to certain terms and conditions, the particulars of which are the payment of concession rent and royalty on production, petroleum profits tax, the continuous and vigorous working of the approved work program in the concession areas, the non- assignment of the grant without the prior approval of the Minister.

In 1999, the Civilian Government constituted the Dr. Christopher Kolade Panel for the Review of Contracts, Licenses and appointments to review the grants of OPLs[77]. Pursuant to the findings of the Panel, the OPLs were revoked on the basis that the procedure for the grants was in breach of the Petroleum Act[78]; and some of the grantees instituted actions against the State[79].

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[77] Oil Prospecting Licenses. See Generally, Yinka Omoregbe, The Oil and Gas Industry; Exploration and Production Contracts (1997)

[78] The government upon reviewing some of the findings of the Panel, revalidated some Opls on the basis that the grantees showed prima facie evidence that their allocations were procedurally in accordance with the Petroleum Act. In the case of Heritage Oil and Gas Limited v. Federal Government and 6 Ors Suit No. FHC/L/CS/855/1999 unreported, the court refused to set aside the Panel's revocation of OPL 247 because the plaintiff had not paid the signature bonus within the period allowed. In the Dajo Oil Lmited v. Federal Government and 6 Ors Suit No. FHC/L/CS/376/2000 unreported, the parties concluded the matter by amicable settlement. See Also Zebra Energy Limited v. The Federal Government of Nigeria and 6 ors(2002) 3 N.W.L.R (Pt 754) 471 C.A

[79] MISR v. Assad (1971) 1 All N.L.R 172

CHAPTER 4

CONTRACTUAL ARRANGEMENTS FOR EXPLORATION AND PRODUCTION.

4.1 Categorization of Joint Venture Agreements.

Contractual agreements are categorized into Pre-license and Post license Agreements. Pre-license Agreements are concluded before the license is awarded whether by discretionary grant or licensing round. Examples of Pre-license agreements are Confidentiality agreements,[80] Area of Mutual Interest Agreement (AMI), Joint Bidding Agreement (JBA) executed between groups of co-venturers). Post-license Agreements such as Joint Operating Agreements (JOA), Production sharing contracts (PSC), and Service Contracts (SC) are entered into between similar parties after the license is granted.

4.2 Pre – License Agreements

4.2.1 Confidentiality Agreements[81] are usually desirable by parties as proprietary information of a non-public nature will invariably be divulged during such negotiations; the execution of a confidentiality agreement is often the first stipulation of the parties. In the upstream oil and gas sector, such discussions often relate to a variety of matters including the formation of an alliance or group to bid for or apply for discretionary grants of acreage, engagement in a joint study and the negotiation of a potential farm- in arrangement. Confidentiality agreements give rise of recourse against any party making unauthorized disclosure of information covered by the

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[80] These are agreements exchanged by parties during commercial negotiations on matters of economic interest. See generally Ernest Smith, John Dzienkowski, Owen Anderson, Gary Canine, John S. Lowe , Bruce Kramer, International Petroleum Transactions (2d ed. 2000)

[81]See John S. Lowe, Owen L. Anderson, Ernest E. Smith, David E. Pierce, Cases and Materials on Oil and Gas, (7th ed. 2002)

agreement to a third party. The agreement has the overall benefit of the parties knowing that they are bound by formal agreement and have entered into their first legal relationship.

4.2.2 Area of Mutual Interest (AMI) Agreements[82] are made where co- venturers agree to record the fact that an area has been identified as an area of mutual interest to the parties within which area the parties agree that their relationship should be subject to certain terms. The parties having identified the area of mutual interest will provide that they will not conduct any negotiations or activities within that area unless in conjunction or consultation with each other. Such activities include provision of seismic or other studies as well as applications for licenses whether under a discretionary grant or licensing round.

4.2.3 Joint Bidding Agreement (JBA)[83] may or may not be preceded by an Area of Mutual Interest (AMI). Where it is preceded by an AMI, it acts as a supplement to the AMI agreement, by addressing the bidding procedures within the area of mutual interest created by the AMI agreement, the joint bidding agreement relates specifically to joint applications for new licenses.

4.3 Post –License Agreements

4.3.1 Traditional Joint Venture: this is the nomenclature ascribed to the Six (6) Joint venture arrangements presently in existence between the NNPC and the Nigerian subsidiaries of Shell, Exxon Mobil, EniAgip, Chevron, Texaco and Elf.

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[82] See generally Judith Rees & Peter Odell, The International Oil Industry; an Interdisciplinary Perspective, (2d ed. 1987).

[83] See Ernest Smith: From Concession to Service Contracts, 27 Tulsa L.J 493(1992) See also, John Burritt Mc Arthur: Coming of Age Initiating the Oilfield into Performance, 23 SMU L. Rev 180 (1997)

4.3.2 Joint Operating Agreement: is a contractual arrangement[84] by means of which co-venturers with proprietary interests in the license conduct operations under the license. This applies to exploration for and production of petroleum, but does not normally cover disposal of produced oil and gas. In a JOA, there are certain clauses such as Participating interest of the parties to the JOA which in the case of NNPC is ratio **60%: 40%** i.e. the percentage interests of each one of the licensees by severing the joint tenancy created by the license and establishing a tenancy in common between the co-licensees who are parties to the JOA. Therefore such matters as expenditure for joint venture operations, liabilities to third parties, ownership of joint venture assets and of any petroleum produced in the contract area are shared amongst the licensees in accordance with their respective participating interests**.**

In a Joint Operating Agreement[85], there has to be an operator of the licensed area, which is usually the Company. Under the Traditional Joint Venture, NNPC holds the majority interest in the joint venture operation and under the indigenous program.

In the JOA, the operator's functions are clearly set out, this includes (i) conducting all joint operations with utmost good faith (ii) making full disclosure to the non-operator of all matters concerning joint operations (iii) selecting its employees for the purposes of the joint operations and submitting their work program (iv) retaining technical, administrative and supervisory personnel and consultants necessary for the conduct of the joint operations.

There is an account owned jointly by the parties to the JOA and they both have a duty not to use the joint venture[86] property for profit. The Traditional Joint Venture JOA provides that each

[84]For reasons of divergent corporate philosophies, tax planning and convenience, the unincorporated joint venture is the basic arrangement of choice in most oil and gas jurisdictions for the conduct of exploration and production activities. See Godfrey Etikerentse, Nigerian Petroleum Law (2d ed. 2004).

[85] This arrangement is established by contract namely a Joint Operating Agreement (JOA). See Richard Krijgsman: The Future of the Oil Majors, 375 Petroleum Rev. (1989)

party shall contribute its participating interest share of all funds required for the joint operations. All costs and expenses of program and budgets and all credits with respect to joint operations shall be ascertained, computed and accounted for in accordance with the provisions of the Uniform Accounting Procedure.

4.3.3 Production Sharing Contract (PSC): This occurs between the proprietary holder or holders of the license and an oil exploration and production company known as **E & P Company**[87].

In the PSC, the E & P Company carries the whole cost of exploration in respect of the contract area rewarded if a commercial discovery is made and development follows. Such reward comes first with recovery of its costs and with a share in production, which is determined by agreement. The PSC contractor therefore has the full right to **"cost oil**" (i.e. oil to recoup production cost) and a share of **"profit oil" (**i.e. oil to guarantee a return on investment**)** after he has defrayed tax and royalty obligations through tax oil on the license holder's behalf.

Royalty Oil: are rates fixed in accordance with the location of the field such that the further or deeper the concession is from onshore, the lower the royalty rate applicable.

Cost Oil: The cost of oil allocation proceeds shall enable the contractor to recover its operating costs in respect of activities in the license area in accordance with accounting procedures set out in the PSC. All operating cost shall be recovered in U.S Dollars[88].

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[86]The JOA provides for the entitlement of each participant "to lift its own share of production and separately dispose of it." See Yinka Omoregbe: The Legal Framework for the Production of Petroleum in Nigeria 5.J.Energy L. 273 (1987)

[87] The term "E&P" refers to exploration and production and most oil producing multinational companies are referred to as Upstream or E & P companies. See Hasan Zakariya, State Petroleum Companies, 12 J.World Trade. L 481(1978) See Also Irene Musselli, Simonetts Zarilli : Oil and Gas Services, Market Liberalization and Negotiations, 8 Int'l l &Econ. 551 (2005)

[88] United States Official Currency.

Tax Oil: Tax oil is that portion allocated to the NNPC (or the holder of the OPL) in such quantum as would generate an amount of proceeds equal to the Petroleum Profits Tax (PPT) liability payment during each month. The NNPC or holder is responsible for the payment of PPT on behalf of the parties. The PPT rate applicable to PSCs is a flat rate of 50% of the chargeable profit for the duration of the PSC.

Profit Oil: The profit oil or production split is the balance of available crude oil after deductions of royalty oil, tax oil and cost oil portions. It is allocated to each party in accordance with the terms of the PSC. Profit oil is shared between NNPC and the contractor at varying levels of production favoring the contractor at lower level and gradually shifting in NNPC's favor as production increases.

4.3.4 Service Contract (SC) Arrangement: The ownership of the concession[89] covered by the service contracts remain entirely in the NNPC. Each service contract relates to a single concession or block. The average primary term of each contract varies between two (2) or (three) 3 years but is renewable at the option of the NNPC for another short period.

Also, if no commercial discovery was made within the primary period, the contract was automatically determined. Under the Service Contract arrangement, the contractor provides all the funds and technical expertise needed for exploring, developing and producing the concession covered by the Service Contract arrangement. The contractor gets reimbursed only from funds derived from the sale of the concessions available oil production; however the contractor does not recover his cost when there was no production. The contractor did not have title to the oil produced but was in practice given an option in respect of it, exercisable even after the life of the

[89] See Ernest E. Smith: From Concessions to Service Contracts, 27 Tulsa L.J 493(1992), See also Jacqueline Lang Weaver & David F. Asmus: Unitizing Oil and Gas Fields around the world, A Comparative Analysis of National laws and private contracts, 28 Hous. J. Int'l l (2006)

contract; as a form of compensation to the contractor in the event that a commercial discovery was not made during the life of the contract. There is a provision in each Service Contract for the NNPC to take over the production activities after a period of three years from the date of commercial production from each field.

4.3.5 Farm-Out Arrangement: This is an assignment[90] of an interest in a license whereby a third party agrees to acquire from one or more of the existing licensees an interest in the license, the consideration for which, in oil industry practice may consist of the carrying out of a specific work obligation. Such work or earning obligation will be conducted by the operator but the costs of the farm-out' share will be borne by the farmor through a cash consideration. The farm out will require the Minister's consent under the Petroleum Act and such consent is therefore given subject to applicable government policies on farm out of interests in the license. The policy of the Nigerian government for the last ten (10) years is to permit farm-out arrangement between the Multinational Oil corporations' subsidiaries in Nigeria in order to encourage exploration by greater risk sharing amongst such subsidiaries.

4.3.6 Marginal Fields: This means an Oil field in a concession held by a major Oil Company not containing a significant discovery and due to certain reasons (e.g. low oil reserves, or high viscosity, or economics) is left unproduced for a considerable length of time. **The Petroleum**

[90] The important point about the legal relationship between the parties is that though they are not partners but separate joint venture companies nevertheless, their liability under the license is joint and several; each being liable for the obligation of the other. See Kammel Khan, Petroleum Resources and Developments, Legal and Policy Issues for Developing Countries 38 Int'l l Comp. L.Q.1 (1989), John S. Lowe : Analyzing Oil and Gas Farmout Agreements, 41 SW. L.J.759 (1987) See also John R. Scott: How to prepare an Oil and Gas Farmout Agreement 33 Baylor L. Rev. 63 (1981)

Amendment Act of 1996[91] vests the Minister with the power to grant and withdraw rights with respects to a variety of petroleum activities. This Amendment provides that *"The Head of State may cause the farm out of a marginal field which has been left unattended for a period of not less than ten (10) years from its first date of discovery"***.**

A farm out can only be brought by the approval of the Head of State under conditions and terms as he may approve.

4.3.7 Marginal Fields Licensing and Contractual Arrangements: When it was discovered that there was a considerable delay in the allocation process as well as in getting parties to negotiate and agree to a farm-out arrangement[92], the government compiled a list of fields, which it declared as marginal and in pursuance of this, conducted a licensing process. The mode of licensing is so unique in that the marginal field's award did not entail the granting of a license, rather it culminated in the grant of a right to negotiate farm-out agreement with an existing leaseholder in respect of an area within the leaseholder's acreage which the marginal field is located. Presently, there is a ***Model marginal field farm out agreement*** for marginal fields as agreed by stakeholders during a meeting with the Department of Petroleum Resources in September 2003.

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[91]The Petroleum (Amendment) Act, (1996) Cap. (23) (Nigeria) defines a "marginal field" as a field which the Head of State, Commander-In –Chief of the Armed Forces my from time to time, identify as a marginal field. See generally Guidelines for Farmout and Operation of Marginal Fields, issued in August 2001 by the Office of the Presidential Adviser on Petroleum and Energy Matters.

[92] See David N. Smith & Louis T. Wells: Mineral Agreements in Developing Countries: Structure and Substance 69, Am. J. Int'l l. 560 (1975) See also James v. Hammett & Deborah Essig Taylor: Oil and Gas Mineral Law, 47 SMU L. REV. 1439 (1994)

CHAPTER 5

LEASING IN THE UNITED STATES

5.1 The Nature and Purpose of the Oil and Gas Lease

In the United States, the term "Petroleum" is referred to as Oil and Gas. The Knowledge of oil and gas in the United States emanates from an Instrument known as the Oil and Gas Lease, which is referred to as a Lease Form. The Oil and Gas Lease is the basic document that governs the exploration for and the production of oil and gas. The Oil and Gas lease is not a lease in the traditional landlord/tenant manner. Oil and Gas lease problems are not governed by the landlord-tenant law or by anything resembling or similar to the landlord-tenant law. The Oil and Gas lease represents a unique business transaction with its own legal characteristics and creates a unique relationship.

In the United States, the Oil and Gas lease is both a conveyance and a contract[93]. Basically, the Oil and Gas Lease is a conveyance under which the Lessor (the owner of the mineral estate) conveys to the Lessee (usually an oil company) the right to explore for and produce oil and gas. The Lessee receives a fee simple determinable in and to all of the oil and gas in place under the property covered by the lease and the Lessor retains a non-possesory royalty interest as well as a possibility of reverter in and to such oil and gas. The oil and gas lease is also a contract between the Lessee and the Lessor under which the Lessee accepts the Lessor's (usually the landowner)

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[93] The oil and gas lease is both a conveyance and a contract. A lease is a conveyance because it is an instrument under which the mineral owner conveys a right to an oil company to explore for and produce oil and gas. A lease is a contract because the oil company accepts the right to explore and produce burdened by certain express and implied promises. One must note that the oil and gas lease in the U.S is a business transaction. An oil and gas lease owner, who generally lacks the capital or expertise to explore or develop, transfers those rights to an oil company (reserving a royalty interest in production). Both parties expect to make a profit from the transaction and the lease sets out their bargain. See generally, Joseph Shade, Primer on the Texas law of Oil and Gas (3d ed. 2004)

offer to use his land to explore for and produce oil and gas, for certain consideration and subject to certain express and implied promises.

The oil and gas lease embodies a business transaction between a landowner, who typically lacks the capital and technical know-how to explore for or develop the minerals underlying her land, and an oil company, which has such capital and technical expertise. The lease establishes the contractual terms of this transaction in which both the mineral owner and the oil company seek to make a profit. The exploration and the production of oil and gas usually require the combination of three basic elements such as land, capital and technology. The Oil Company contributes the land, which is the raw material that an oil company needs for oil and gas development. Generally, the company does not want the expense of owning the land, but merely wants to control the land for purposes of oil and gas exploration and development.

In the United States, the landowner transfers the right to develop the minerals to an oil and gas company to conduct operations on the landowner's land at the oil company's sole risk and expense. In exchange, the Lessor receives money up front in the form of bonus and the expectation for more money, if a good well is completed, in the form of royalty. Usually the final expectation of both the Lessor and the Lessee is profit from the production of the oil and gas even though their immediate goals are different. While the Lessee wants exploration rights on the land for a long period of time, the lessee also wants an option but not an obligation to drill[94]. If the Lessee gets to produce oil from the land, then it wants to hold the lease for as long as it is profitable to do so[95]. The Lessee wants its rights to use the surface for exploration to be as broad

[94] This is what the Lessee gets during the primary term of the lease. See Ernest E. Smith & Jacqueline Lang Weaver, Texas Law of Oil and Gas 1-3 (2d ed.2003) See also Joseph Shade: Oil and Gas Lease and ADR, A marriage in Heaven waiting to happen, 30 Tulsa L.J 559(1995)

[95] This is what the Lessee gets during the secondary term of the Lease.

as possible[96]and of course, wants to pay as little as possible for all these rights. Since the short-term interests of the Lessor are often different from those of the Lessee, disputes frequently arise. The main types of disputes which usually arise between lessors and the lessees are disputes involving the Surface Use; Lease Termination, Implied covenants and Royalty.

A good understanding of the principle underlying the business transaction between the Lessor and the Lessee will help to have a clear perspective of the legal rules which govern disputes between lessors and lessee. For instance, an issue might arise as to whether a particular payment is royalty or bonus. Under the business transaction, both bonus and royalty are consideration paid to the Lessor for the lease. The amount on the bonus and royalty are subject to negotiation and the Lessor may accept a lower bonus in exchange for a higher royalty or vice versa. This issue might arise where a third party who is the owner of a nonparticipating royalty interest is entitled to a share of the royalty, but not the bonus. Usually, the rule is that an interest in production that extends over the life of the lease is referred to as the royalty.[97]

5.2 Surface Use Problems

Surface use problems arise under the granting clause in the Lease form. The granting clause gives the Lessee the right to reasonable use of the surface for purposes of developing the minerals. Where there is a severance of the mineral and the surface estates, the mineral estate is the dominant estate. The dominant estate rule simply means that the surface estate is burdened with servitude. The mineral owner (Lessee) has a right of ingress and egress as well as a right to use as much of the surface as is reasonably necessary to explore for and produce minerals.

[96] It is important to note that the Lessor and the Lessee are operating two different businesses on the same tract of land. While one is exploring for oil and gas, the other is typically farming or ranching.

[97] Lane v. Elkins, 441 S.W.2d 871(Tex.Civ. App.1969). See Also Owen Anderson: Anatomy of Oil and Gas Drilling Contracts, 25 Tulsa L.J 359 (1990)

Because the mineral estate[98] is dominant, the Lessee is not obligated to pay for using the surface, nor is he obligated to maintain or restore the surface in the absence of a statute or lease provisions requiring such restoration.[99] The Lessee is expected to use the surface reasonably.

The term “reasonable use” includes geophysical exploration, drilling, building roads, installing machinery and storage tanks, and using such water as is reasonably necessary to accomplish the purposes of the lease. The rule of reasonable use limits the Lessee to using no more of the surface than is reasonably necessary to develop minerals. For instance, if it takes one acre to drill a well, the Lessee cannot use two acres. The Lessee’s use has to be related to developing minerals under the particular leased property. The Lessee cannot use the surface of the Lessor’s land to transport gas it has produced from a different piece of property to its pipeline; nor can the Lessee use the Lessor’s land to store equipment used to develop another owner’s land. There is a limitation known as the **Accommodation Doctrine.** This was established in the case of **Getty Oil Co. v. Jones.**[100] The Accommodation doctrine states that if the proposed use of the surface by the mineral owner will substantially impair existing surface uses and the mineral owner has reasonable alternatives available, the mineral owner must accommodate the surface owner. In **Getty Oil Co. v. Jones**, there was an illustration of the application and limitations under the Accommodation Doctrine. In this case, Getty installed a pump jack to produce oil from a well drilled on Jones’ farm. The pump jack, which extended to a height of about seventeen feet on the upstroke, interfered with a seven-foot high rotating irrigator, which Jones had used for many years to irrigate his land. The court applied the Accommodation Doctrine and ordered Getty to sink the pump jack below the surface of the ground to avoid interference with the irrigation

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[98] See Samuel K.B Asante: Restructuring Transnational Mineral Agreements 73 Am. J. Int’l l 335 (1979)
[99]Examples of these statutes are environmental statutes, ordinances etc which may require restoration. Clauses limiting the surface use or requiring restoration are frequently inserted in the lease by the lessor.
[100] Getty Oil Co. v. Jones, 470 S.W.2d 618 (1971).

system. Though the accommodation doctrine is not a weighing test. The rotating irrigator was an existing use and the sinking pump jack was a reasonable alternative. Both facts are necessary to invoke the accommodation doctrine. The legal standard for liability for surface damage of a Lessor's land is negligence. Often times, it is assumed that the standard is strict liability, because oil companies are generally willing to pay for such damages. Oil companies realize that they often lose these types of suits, which are usually tried in the Lessor's home country, where the Lessor's neighbors are members of the jury. Nevertheless, the legal standard is negligence.

Under the dominant estate rule, the Lessee has a right to use the surface in a way that is reasonably necessary to explore for and develop the minerals underlying the property, subject to limitations such as the rule of reasonable use, the accommodation doctrine, negligence, statutes, ordinances and terms of the lease. Usually, the granting clause in the Lease gives the Lessee the right to explore for minerals; this includes drilling a well, seismic and other activities related to exploration. The granting clause also enumerates substances, which are covered by the lease, and describes the property under the lease.

5.3 Lease Termination Problems

There are various problems associated with the lease termination disputes. These are the Habendum Clause, the Drilling and Delay rental clause and the Savings Clause. The habendum clause fixes the ultimate duration of the lease while the Drilling and Delay rental clause may cause the lease to terminate earlier. The Savings clause may enable the lease to remain in effect by something other than production. The basic effect of the Habendum and the Drilling and Delay Rental clause is to create a timeline, which divides the term of the lease into its primary term and the secondary term. The primary term usually is for a period of three to five years or for the period stated in the lease. At this time, the Lessee can exercise his option to drill; this is just an option but not an obligation to drill. However, under the Drilling and Delay rental clause the Lessee must either drill or pay delay rentals. This must be done on or before the anniversary date of the lease. The secondary term will last as long as oil and gas is produced from the lease[101], this period could only last for a short time. The timeline established by the primary term and the secondary term represents the business transaction. It gives the lessee the option but not the obligation to explore during the primary term; but if there is production, it gives the lessee the right to hold the lease as long as it is economically viable to do so[102]. In order to hold the lease during its secondary term, the Lessee needs production or he needs to satisfy at least one of several savings clauses in the lease. In situations where there is no production, the lease will not terminate because of the operation of one or more of the savings clauses. The most important savings clauses[103] are the shut- in royalty clause, dry hole, operations and ceasation of production clause and force majeure clause. The ceasation of production clause deals with ceasation of production. For instance if the well ceases production, the lessee can keep the lease alive, if the lessee commences repairs within the period stated in the lease. While the operations part of the clause deals with the situation encountered in the case of **Baldwin v. Blue Stem Oil Company**[104] where at the end of the primary term, operations were still in progress but actual production had not yet commenced[105]. The operations portion of the operations clause specifies that the lease will not expire if operations are commenced prior to the expiration of the primary

[101]Modern lease forms only use the term “produced”. In a situation where the economic purpose of the oil and gas lease is to produce oil and gas profitably and when this can no longer be done, the lease should then terminate.
[102] A modern oil and gas lease might be in effect for a short time until the first delay rental payment is due. or may be for a long time as long as there is production in paying quantities from the land.
[103] The pooling clause also operates as savings clause, but this is incidental to its main functions.
[104] Baldwin v. Blue stem Oil Co. , 189. P.920, 920 (1920)
[105] Id. at 921

term and continues to completion, with no ceasation of operations for the period stated in the lease. This allows the Lessee to finish what he has begun if he acts with due diligence[106]. The dry hole part of the clause covers a situation where the lessee during the term of the lease drills a dry hole but desires to drill a second well before the lease expires.[107] Most modern lease forms contains a savings clause, which provides that if the lessee drills a dry hole, he can keep the lease alive by starting to drill another well on the leased property within a stated period of time, which is usually sixty days. The main purpose of the operation clause is to maintain the lease in the event of temporary delays or interruptions of production, all of which are events that lessees may experience. The operations clause will guard against such contingencies.

5.4 Implied Covenants

During the term of the lease, disputes may arise between Lessors and Lessees under any of the express clauses of the oil and gas lease or under the implied covenants. Implied covenants are unwritten promises that impose duties on the lessee[108]and protect the lessor. The implied covenants are imposed by the courts and arises out of the relationship of the parties and the main objective of the oil and gas lease[109]. There are six separate implied covenants[110]; these are covenant to protect against drainage, develop, test[111], explore, market and operate properly.

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[106] This clause permits a lessee to commence a well before the end of the primary term, abandon it after the end of the primary term and continue to hold the lease by starting another well within 6o days. This version of the clause is called a continuous operation clause. Rogers v. Osborn , 261 S.W. 2d 311, 314-15 (1953).

[107] The lessee obtains information from the drill core indicating that if it moves the location 100 feet to the west, he may encounter a producing formation.

[108]Also, there are two implied covenants that impose duties on the lessor and protect the lessee; the implied covenants of warranty and quiet enjoyment. Roger A. Cunningham et al., The Law of Property P.80(1984)

[109] The business transaction between the lessee and the lessor is structured in such a way that both parties make money from good production. The lessor contributes the land and gives the lessee all of the operating rights. The lessee contributes the capital know -how and assumes the risks. Under this type of

In **Sun Exploration and Production Co.**[112] **v. Jackson**, the Lessee; Sun had a lease covering 10,000 acre on Jackson Ranch**.** It had fully developed a relatively small portion of the lease overlying a producing reservoir known as the Oyster Bayou Field. However, Sun had not explored other portions of the land covered by the lease. There was a jury finding that Sun did not fail to reasonably develop the Jackson lease, which on rehearing, the court held was disposive because in Texas no implied covenant to further explore exists independent of the implied covenant of reasonable development. There is a trend toward implying only one covenant expecting the lessee will act as a reasonable and prudent operator[113] this was decided in the case of **Amoco Production Co v. Alexander**[114]**.** Whether the issue is about drainage, development, marketing or operations, if the lessee does what it takes to fulfill the business purpose of the lease, as required by the reasonable and prudent operator standard, all of the implied covenants should be satisfied. But if the lessee does not act like a reasonable prudent operator, he is likely breached one or more of the implied covenants. The reasonable prudent operator standard is simply a vehicle for applying objective standards to emphasize the scope of the lessee's duty. This standard is usually higher than the standard of good faith, which is imposed on every party to a contract. However the reasonable prudent operator is not a

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arrangement, there is an implication that the lessee knows what he is doing and he will perform competently, diligently and in good faith.

[110] Some scholars have classified the implied covenant differently but the basic idea is the same. Richard W. Hemingway, The Law of Oil and Gas, 445-47 (3d ed. 1991).

[111] Most courts have held that the presence of a delay rental clause in the lease obviates any implied covenants to test. See Warm Springs Dev. Co. v. McAulay, 576 P.2d 1120 (1978); E. Oil Co. v. Beatty, 177 P. 104 (1918).

[112] The Texas Supreme Court held that no implied covenant to further explore exists independent of the implied covenant of reasonable development. Sun Exploration & Prod. Co. v. Jackson, 783 S.W.2d 202, 204 (1989); However under some circumstances reasonable development may carry a duty to do some further exploration. See Mitchell v. Amerada Hess Corp., 638 P.2d 441 (1981).

Oklahoma is in accord with this view while other states recognize a covenant to further explore, as separate and distinct from the covenant of reasonable development.

[113] John S Lowe, Oil and Gas in a Nutshell, page 80 (4th ed. 2003)

[114] Amoco Prod. Co. v. Alexander, 622 S.W.2d 563 (1981).

fiduciary[115]. The reasonable prudent operator can act in his own self-interest but he must act in good faith, act as a competent operator and with due regard for the interest of the lessor.[116]

5.5 Royalty Problems

The word **"royalty**" is a real property interest with two distinguishing characteristics. It is a non possessory and it is free of production and operating expenses. The owner of such an interest has no right to explore, drill or produce oil and gas; also, he normally has no right to execute oil and gas leases. The principal benefit conferred by royalty ownership is the right to a fraction of oil and gas or mineral production free of drilling, mining and operating expenses. The common understanding of the term "royalty" is both underinclusive and overinclusive. It is under underinclusive because it is does not fully encompass all contexts in which the word is used. The separation of all possessory rights from a mineral fee interest will not automatically transform it into a royalty[117] and rights normally attached to a mineral fee interest including the right to participate in leases[118], can be attached to a royalty. Most of the time the royalty owner is given specified rights to use the surface and subsurface or rights to share in lease benefits in addition to production.[119]

Additionally the word "royalty" is used in oil and gas leases and some other instruments to describe payments that are not based on production. The most common is shut-in royalties, which are payments, made to maintain a lease where all wells have been shut for lack of a market. This term has also been used to refer to a lessor's share of oil and gas after they have

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115 He is not a person who acts primarily for the benefits of someone else.
116 Lowe, supra, at page 83.
117 See Buffalo Ranch Co. Ltd. v. Thomason, 727 S.W.2d 331 (Tex. App. 1987). See also John S. Lowe Defining the Royalty Obligation, 49 SMU L. Rev. 223, 234 (1996)
118 Elick v. Champlin Petroleum Co., 697 S.W.2d 1 (Tex. App. 1985).
119 See Brady v. Sec. Home Inv. Co., 640 S.W.2d 731 (Tex. App. 1982).

been produced or the money payable to the lessor from the sale of such production.[120] The common understanding of royalty is overinclusive in that it encompasses interest not usually referred to as royalties. For example the owner of a production payment has a non possesory interest which entitles her to an expense-free share of production, but she is not usually considered to own the royalty.

5.5.1 The General Nature of Royalty

Since the oil and gas lease establishes the business relationship between the Lessor and the Lessee, Royalty is paid to the Lessor by the Lessee as partial consideration of the lease.[121] If production is obtained, royalty will likely be the main compensation received by the Lessor for the Lease. Royalty is simply a share of the product payable in kind or in money. It is a share of production free of the cost of production. The Lessor's fractional share of production represented by his royalty is negotiated between the Lessor and the Lessee, Initially 1/8 was once the standard royalty, but this is no longer the case. Presently, royalty can be any amount that the parties negotiate. The typical range of royalties today is between 1/8 and ¼. Once there is a lease relationship between the lessor and the lessee and production is obtained, the lessor can increase her royalty income by increasing the volume of production on which royalty is due or by increasing the value of such production. Both the express terms of the lease- primarily the royalty clause as interpreted by the courts and implied covenant to market are the lessor's main tools for maximizing value. One must note that royalty issues involve gas rather than oil.

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[120] See Jones v. O'Brien, 251 S.W. 208 (Tex. Comm'n App. 1923). See also John Lowe: Defining the Royalty Obligation, 49 SMU L. Rev 223. 224 (1996)

[121] See "Royalty Interests,"§ II.C.5. (b) Stating the different kinds of royalties, which can be created in oil and gas transactions: non-participating royalties, overriding royalties and lease royalties.

Royalties are not due on value but only on the value of production saved, removed or sold from the leased property. Consequently, royalties are not owed unless and until actual production[122], the severance of minerals from formation occurs.[123]

Texas courts have followed the same reasoning. Where the lease royalty clause calls for payment of royalty on "gas produced", the Texas courts have held under the plain meaning of those words that there must be production and "**production"** means physical extraction of gas from the ground.[124] Not only in Texas, but also most other jurisdictions where the take or pay question has been litigated have reached the same conclusion based on the same reasoning. However two jurisdictions have held otherwise. The Supreme Court of Louisiana in **Frev v. Amoco Production Co**.[125] and the Eight Circuit applying Arkansas law in **Klein v. Jones**[126]**,** have held that royalty owners are entitled to share in the settlement of take or pay obligations.

Thus with respect to the market value litigation, there are two views as to the lessor's right to share in the take or pay settlement. The first which is represented by **Hodel v Bruni** which is the view followed in Texas holds that the lessor is not entitled to share in the take or pay settlement because of the express terms of the lease provided for royalty "**on production**" (the "**plain terms**" approach). The other view represented by **Frey v Jones** holds that the Lessor is entitled to share because it is one of the benefits derived forms the lessor/lessee relationship (the "**cooperative venture**" approach).

122 Diamond Shamrock Exploration Co. v. Hodel, 853 F.2d 1159 (5th Cir. 1988) the most widely cited case holding that royalty owners are not entitled to share in take or pay settlements
123 Id. at 1165.
124 See Killam Oil Co. v. Bruni, 806 S.W.2d 264 (Tex. App. 1991).
125 Frey v. Amoco Prod. Co., 603 So. 2d 166(1992).
126 Klein v. Jones, 980 F.2d 521 (8th Cir. 1992).

The conclusion on the analysis of both the majority and the minority rules in the take or pay cases is that states following the Vela Rule in the market disputes are less likely to allow royalty owners to share in take or pay settlements than those following Tara Rule[127].

The remedy for non- payment of royalty is an action for damages; not an action for forfeiture.

In Texas for example, it is stated that failure to pay royalties normally does not result in termination of the lease, but rather merely an action for damages. This rule is based on the law of contract, which is the law of promises and conditions. Failure to pay royalty will constitute a breach of promise resulting in action for damages. Unlike failure to pay delay rentals, failure to pay royalties is not a failure of a condition resulting in forfeiture.

5.6 Leasing on Federal and State Owned Lands.

5.6.1 Federal lands.

Both the federal and state governments own property, which they lease for oil and gas development. The federal government owns over 700 million acres of land or about 30 percent of the land in the United States, not including off shore property. The federal government annually receives approximately $120 billion in payments on account of its oil and gas interest. Most federally owned land is in the western states or offshore. Majority of the land owned by the federal government is referred to as **public domain** which is an unpatented land which remains under the ownership of the federal government. Although, leasing on federal government land is a major issue in some western states, such as New Mexico, Wyoming and Alaska, it is generally not an issue in Texas because, except for acquired lands- lands acquired for post office, interstate

[127] See generally John S. Lowe, Defining the Royalty Obligation, 49 SMU L. Rev. 223, 234 (1996). See also John S.Lowe, Owen L. Anderson, Ernest E .Smith, David E. Pierce, Eugene Kuntz, Forms Manuals to accompany cases and materials on Oil and Gas Law, (2004).

highways etc-the federal government does not own any land in Texas. The reason is that Texas, unlike other states joined the union as a sovereign nation and the State of Texas retained title to all of its public domain.

The federal government has extensive regulations, which govern leasing on federal, paying royalties on federal leases. One must note that while the principle of private ownership of minerals is well recognized in the United States, this is a minority view. In most of the parts of the world including common law countries, (apart from the United States and Canada), which recognize private ownership of the surface; the minerals are owned by the sovereign.

5.6.2 State Lands- Texas Relinquishment Act

Texas amongst other states, has significant oil and gas holdings, however Texas revenues from these interests are declining. One must note that when leasing land owned by the State of Texas, the Relinquishment Act comes to play.

Before 1895, all patents issued by the State of Texas included mineral rights.[128] However in 1895, recognizing the value of oil and gas, the State of Texas classified certain land that had not yet been patented to private individuals as mineral lands and the State began reserving the minerals in those lands. In other words, persons who received patents to certain lands after 1895 (mostly in West Texas) got title to the surface but not the minerals, title to which were retained by the State. The surface owners objected on the basis that the state and its lessees were damaging the surface while denying the surface owners any benefit or compensation. In response to this, the Texas legislature passed a series of statutes called the **Relinquishment Act.** The effect of the Relinquishment Act was to give the surface owners of lands patented by the state

[128] Every title to privately owned lands begins with a patent from the sovereign. In most states title emanates with a patent from the federal government. In Texas land titles emanates from patents granted by Spain. Mexico, the Republic of Texas or the State of Texas.

between 1895 and 1931 in which the state reserved the mineral rights, the right to share in the economic benefits under the lease.

The Relinquishment Act did not actually result in relinquishment of the minerals- the state retained mineral ownership. By statute, however the landowner was made the agent of the state for leasing purposes. As compensation for leasing and surface damages, the landowner gets to keep one-half of the lease benefits (i.e. bonus, royalties etc) subject to statutory limits. Also by statute, the surface owner is a fiduciary for the state with respect to Relinquishment Acts lands. Thus, fact situations involving patents from the State of Texas between 1895 and 1931 should raise a red flag regarding the possible application of the Relinquishment Act.

5.7 Contractual Agreements

Oil Companies usually enter into many contracts, one has to be able to differentiate the different types of contracts used in oil an d gas operations as many legal issues emanate from such contracts. For instance contracts between oil companies and drilling contractors.[129] Oil and gas contracts are subject to the same rules, which govern contracts generally rules relating to offer, acceptance, consideration etc. Oil and gas leases are assignable and oil companies assign such leases. There are two unique agreements related to the exploration and production of oil and gas and the oil and gas business generally. These agreements are the Farmout Agreements and Joint Operating Agreements.

[129] Drilling contracts are agreements for drilling a well entered into by drilling contractors also known as service companies, which own drilling rigs and other equipment and oil companies, which own mineral or leasehold rights that they desire to develop. Owen L. Anderson, Anatomy of an Oil and Gas Drilling Contract, 25 Tulsa L.J. 359 (1990).

5.7.1 Farmout Agreements

A farmout Agreement[130] is an agreement under which a person who owns an oil and gas lease (the "farmor") agrees to assign the lease or a portion thereof to another person ("the farmee") in exchange for the farmee's agreement to drill on the acreage covered by the farmout agreement. This agreement is quite common between operators under which a lease owner, who does not want to drill, agrees to assign the lease or some portion thereof to another operator who does want to drill on the acreage. The farmee agrees to drill one or more wells at its sole cost or expense. In most cases, the farmor will still

retain an interest in the assigned acreage; usually an overriding royalty interest or production payment and the farmee will earn the assignment only if he drills the well. Farmout agreement is a main vehicle used by oil companies in trading for lease to put together blocks of acreage needed to develop their prospects and a means of spreading costs and sharing geological information. The main purpose of a farmout is earning leasehold acreage by drilling. If earning by drilling is not part of the deal, then it is not a farmout agreement, but a lease purchase or any other type of lease transfer deal.[131] Farmouts can vary significantly and there is no standard form for a farmout agreement. Most farmout agreements are in a form of letter agreement from the farmor to the farmee, which specify what the farmee will do to earn the acreage (i.e drill a well) and the nature and size of the interest the farmor will earn as consideration for the farmout.

In a farmout agreement, the farmee's motive is to put together a block of acreage on which to conduct his operations. The farmout agreement is usually a cost effective way of earning acreage because the consideration usually paid is often an interest in future production, rather than an up-

[130] John R. Scott, How to Prepare an Oil and Gas Farmout Agreement, 33 Baylor L. Rev. 63 (1981); John S. Lowe, Analyzing Oil and Gas Farmout Agreements, 41 SW. L.J. 759 (1987).

[131] In some situations, some refer to all agreements as farmout agreements but in all reality they are usually not.

front cash payment. The farmor's motives are as follows: he may not be geologically optimistic about the acreage farmed out, he may not have the money to drill, he may be holding leases about to expire or may want to obtain geological information. Most farmout agreements are in the form of a letter agreement from the farmor to the farmee, which basically specifies what the farmee will do to earn the assignment of acreage and what the farmor will earn as consideration for such assignment. Farmout agreements, being real estate contracts are within the statute of frauds and governed by the same rules that govern contracts. In a farmout agreement, the farmor and the farmee must negotiate the acreage, which the farmee may earn, what the farmee has to do to earn the acreage and the size of the override or other consideration that the farmor will receive. The specific provisions of a farmout agreement must contain are the identity of the leases and lands, the obligations of the farmee (i.e the drilling initial well, conditions to drilling, tests to be performed and the information and reports), the obligations of the farmor (which includes the interest the farmor will retain, the interest the farmor will assign and the conditions of the assignment), the further development of the prospect area and subsequent wells. One must also note that farmout agreements are flexible arrangements, which will vary substantially from deal to deal.

5.7.2 Joint Operating Agreements

A Joint Operating Agreement (JOA), sometimes called operating agreement, is a contract between co-tenants or separate owners of oil and gas properties that are being operated jointly. It is one that looks like a joint venture agreement for operating purposes. It defines the rights and duties of the co-owners of the oil and gas properties and sets out the parties' agreements with respect to initial drilling, further development and operations on the jointly owned properties. It also establishes the sharing costs and expenses and accounting with respect to joint operations.

Joint Operating Agreements govern operations involving immense financial risk and reward; the parties to a Joint Operating Agreement are experienced individuals with strong bargaining positions, this is because these agreements involve liabilities and obligations unique to the legal and technical peculiarities of the oil and gas industry.[132] Only people with operating interests or participating interest are parties to a Joint Operating Agreement. These normally would include lessees, owners of unleashed mineral interests and assignees of working interests (typically investors).[133] In a joint operating agreement, there is a standard printed form. It is so called AAPL[134] or ("Form 610 JOA") and most people in the oil industry use a version of this form. The joint operating agreement sets out the rights and obligations of the joint owners with respect to drilling both the test well and any subsequent wells, sharing costs and revenues, operations and accounting. It pools the interests of parties for operating purposes. It also sets up a so-called joint account out of which expenses are paid and revenues are distributed. Each JOA is a contract among the parties to such agreement and rules of contract construction generally apply in determining the rights and liabilities of the parties to one another. It also makes the actions of one party the actions of all parties to the agreement. Parties owning working interests in one or more leases in the contract area (the lands and leases covered by the agreement) would ordinarily appoint one of their number as " operator" while the other signors of the operating agreement are referred to as " non-operators". Under the JOA, the operator is empowered to operate the well or area for the benefit of all joint owners. The operating agreement enumerates both the authority and the obligations of the operator. It also provides a mechanism for removing or changing operators. The operating agreement also provides for the drilling of an initial well in the contract

[132] Hill v. Heritage Res. Inc., 964 S.W.2d 89, 112 (Tex. App. 1997).
[133] Persons who invest in oil deals as working interest owners usually sign JOAs.
[134] American Association of Professional Landsmen has promulgated four basic versions of its form 610 Operating Agreement- the 1956, 1977, 1982 and 1989 forms are all used today. Though they are similar, they still differ in some material ways.

area and provides that the operator shall pay all costs and expenses, but shall charge each of the parties to the operating agreement their proportionate share of the expenses based on the "COPUS Form of Accounting Procedures," which is usually attached as an exhibit to the operating agreement. The JOA is simply a vehicle through which joint owners conduct operations without assuming the status of partners.

CHAPTER 6

A COMPARISON BETWEEN NIGERIA AND THE UNITED STATES

6.1 The Position in the United States

In the United States, the basic document of the oil and gas industry is the oil and gas lease which authorizes an operator, the lessee or his assignee to enter upon described premises for the purpose of exploring for and developing the mineral resources in the premises. As a result of judicial decisions, the lease form has been modified from time to time. The modern oil and gas lease is the evolutionary product of conflicts between the landowner and the operator of the oil and gas interest. The operator is desirous of securing a lease with a small capital investment, keeping the lease as long as it was productive or was valuable for speculative purposes, and at the same time, being able to terminate an unprofitable lease without liability to the lessor. The landowner on the other hand, has been interested primarily in obtaining royalties from the lease and therefore has pressed for early exploration and development operations. In lieu of exploration and development operations, the lessor has tried to secure a periodic return for the holding of the leasehold interest. However, the lessor has also wanted to limit the time the lessee can postpone drilling by periodic payments, in order to prevent the lessee from holding the lease merely for speculation, and to assure the exploration and development of the lease within a short time.

The first commercial well in the United States was drilled under a fixed, long –term lease lacking a “thereafter”. This type of lease terminated at the end of a fixed period regardless of whether the lessee had obtained profitable production. Such a lease was unsatisfactory to the lessee since it failed to guarantee him the opportunity to realize the full return on his speculative investment. This fixed- term lease was also unsatisfactory to the lessor. Since the monetary compensation paid for the lease initially was nominal and since such lease did not provide for delay rentals, the lessor would not realize any return from the mineral interest unless there was production. These leases frequently contained a clause permitting the lessee to remove all machinery and equipment from the land at the end of the term. Since this clause was held to permit the removal of well casing, the withdrawal of the lessee with the equipment could destroy much of the value the lessor had gained by the development of the mineral interest.[135] The major reason for the disappearance of this mutation of the oil and gas lease however was dissatisfaction of lessors with the form. Lessors did not like a form, which permitted the lessee to hold lease for substantial periods without development and without any periodic consideration (rentals) paid to lessors.

In the United States, the Mineral Interest is real estate, regardless of the ownership theory; both estates and profit are real estates. The lease is both a contract and a deed but most states treat it as real property. The Lessee has the right to take substances as well as use the land. The Lessee's rights are potentially perpetual; both the Lessor and the Lessee share the land. The various states within the United States classify differently.

In Texas, fee simple is determinable in the minerals; In Oklahoma, profit a prendre[136] is subject to equitable termination; In Kansas, license may become irrevocable. In the states of Texas, Colorado, New Mexico, Michigan and North Dakota, the owner of oil and gas rights owns the right to search, develop and produce plus a possesory right to the oil and gas in place beneath the owner's tract. These rights create a mineral estate in land. In Oklahoma, Louisiana, California, the owner of oil and gas rights own rights to search, develop and

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[135] Howard R. Williams & Charles J. Meyers, <u>Manual of Oil and Gas Law Terms</u> 113-145(9th ed.1994)
[136] Right to the fruits of another's land.

produce but no possesory right to oil and gas in place. These rights create a profit a pendre to extract minerals.

In the U.S, Leases are structured like deeds, it is generally signed only by the lessor and the lessee is bound when it accepts the lease. Both the Lessor and the Lessee initial the lease changes and initial or sign lease addenda. The lands covered are the surface boundaries, which typically define the limits, the metes and bounds descriptions and the rectangular government surveys. The metes and bounds locate property by reference to its exterior boundary lines in terms of natural or artificial "monuments" (such as creeks and rocks) and directions and distances. The Descriptions tends to be lengthy and poetic for example "beginning at the granite boulder on the north side of the bridge over Oil Creek, thence northeasterly 280E thirty rods to an iron stake, thence East by Northeast to the white oak tree…".

Lastly one must not that the relationship between and lessor and the lessee in the United States is that it is a business transaction.

6.2 The Position in Nigeria.

In Nigeria, Licenses and leases are governed by the Petroleum Act.[137] One main point that we must note here is that in Nigeria, the Minister is endowed with a wide discretion of powers. The Petroleum Act empowers the Minister to grant to persons as he thinks fit licenses and leases to explore, prospect, search for, win, carry away and dispose of petroleum. The Application for the Oil Exploration License, the Oil Prospecting License and the Oil Mining Lease is made to the Minister of Petroleum Resources in a prescribed form.

[137] Laws of the Federation of Nigeria, (1990) Cap. (350)

The grant of a license or a lease is at the sole discretion of the minister; the assignment of an Oil Mining Lease, interest right or power derived from it is prohibited without the consent of the Minister. The state is vested with the entire ownership or control of all Petroleum in accordance with Section 1 of the Petroleum Act Laws of the Federation of Nigeria 1990; and decides on whether or how petroleum is to be explored.

In Nigeria, Licenses are subject to the surface rights of the owners[138] or occupiers of the area of license to explore for petroleum i.e. the communities; and there are limitations on the various licenses and leases because they have their own lifespan and termination periods. In addition, the Federal Government of Nigeria has proprietary rights to the data gathered by the Licensee during the life of an Oil Exploration License. One-half of the lease area of an Oil Mining Lease is subject to relinquishment by the lessee ten (10) years after the grant of the lease except the Oil Mining Lease has been renewed. Licenses and leases may be revoked if the licensee or lessee becomes controlled directly or indirectly by a citizen of subject.

Furthermore, the Petroleum Act contains the provisions on the exploration of petroleum in the territorial waters and continental shelf of Nigeria and the first schedule to the Act sets out the forms of Oil Exploration Licenses, Oil Prospecting Licenses and Oil Mining Leases.

One must therefore bear in mind the following under Nigerian Law. Firstly, an Oil Mining Lease (OML) is like any lease and as such liable to payment of stamp duties[139]

Secondly, that by virtue of the provisions of the Petroleum (Drilling and Production) Regulations[140] an Oil Exploration License, Oil Prospecting License or Oil Mining Lease may

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[138] See Nwadiaro v Shell B.P (1990) 5 N.W.L.R (Pt 150) P 332

[139] Stamp Duties 411, Laws of the Federation of Nigeria, (1990) and the Schedule of Rates dated 1 July 2002 published by the Joint Tax Board. See also State Civil Service Commission & Anor v. Alexius Ikechukwu Buzugbe (1984) N.L.R 372, Federal Civil Service v. J.O Laoye (1989) 2 N.W.L.R (Pt 106) 652.

[140] Laws of the Federation of Nigeria (1990) Cap. 350

require registration at the Land registry of the state where an OML is located[141] and where that is done by the holder, it behooves it to supply one copy of the registered license or lease to the Director of Petroleum Resources.

Under the Petroleum Act, Oil Mining Lease is granted pursuant to Section 2 of the Act and its terms are set out in the First Schedule to the Act. Section 3 of the First Schedule sets out the legal regime for renewal of leases granted pursuant to the Act and states that an Oil Exploration License is valid until 31 December next following the year it was granted. It however confers on the licensee an the option to renew the license for one further year if (i) he has fulfilled all obligations imposed on him by the Act; (ii) the Minister is satisfied with work done and reports submitted to him in pursuance of the license and (iii) the application for renewal has been submitted at least three (3) months before the expiry of the license.

With regards to Oil prospecting license, Section 6 of the First Schedule gives the Minister the discretion to determine the duration of the license provided it does not exceed five (5) years including any periods of renewal[142]. As for the duration of the Oil Mining Leases, the Petroleum Act stipulates in Section 10 of the First Schedule "the term of an Oil mining lease (OML) shall not exceed twenty years, but may be renewed in accordance with the Act."

Section 13 provides that the lessee of an OML shall be entitled to apply to the Minister for the renewal of the lease, not less than twelve (12) months before the expiration of the lease, and that the renewal shall only be granted if the lessee has paid all rents and royalties due under the lease and has performed all obligations under the lease[143]

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[141] See Regulations 8 and 61. of the Petroleum (Drilling and Production) Regulations

[142] See Section 6 of the First Schedule to the Petroleum Act Laws of the Federation of Nigeria 1990.

[143] See Attorney General of Southern Nigeria v John Holt & Co. (1951) A.C. 559, See also Sir Adetokunbo Ademola v. John Ammo (1982) Ogun State Law Reports 273.

6.3 Differences and Similarities between both jurisdictions.

In the United States,

a) The entire property and control of all petroleum in, under or upon any land belongs to the owner of the land. A person who owns land[144] which an oil company desires to develop for oil and gas, leases that land to the oil company.

b) The landowner, as lessor, authorizes the oil company, as lessee, to conduct operations on the landowner's land at the oil company's sole risk and expense. The power to renew or extend a lease is entirely vested in the landowner; it is at his sole discretion to extend the lease further than the initial duration.

c) The landowner grants a lease to the oil company further to a request by the oil company to explore for oil and gas on the landowner's land.

d) In the United States, the low level of availability of petroleum does not amount to a declaration of a state of national emergency. More so, each state law governs its state within the United States.

e) In the U.S, the terminology used is the oil and gas lease.

f) The landowner receives certain consideration consisting primarily of royalty and bonus[145].

g) The Oil and gas lease creates a relationship between the lessor and the lessee, which may last for generations[146]. The long-term expectations of both the lessor and the lessee are

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[144] The landowner owns both the surface and the minerals underlying his land. Eugene O. Kuntz et al, Cases and Materials on the Law of Oil and Gas 11-15 (2d ed.1993)

[145] The amount of the royalty and bonus are matters negotiated between the lessor and the lessee. The amount varies widely depending on the desirability of the land in question as a prospect for oil and gas development.

the same, which is the expectation of profit from oil and gas production. The business deal, evidenced by the oil and gas lease is structured in such a way that if a good well is developed on the leased property, both the lessor and the lessee will profit.

h) The landowner gives the oil company the entire right of the land during the duration of the oil and gas lease and does not in anyway interfere except the oil company commits a wrongful use of the land.

i) The modern oil and gas lease may terminate on its first anniversary date if the lessee fails to pay delay rentals or fails to fulfill its obligations.

j) The United States makes use of the Joint Operating Agreements and the farm out Agreements.

While in Nigeria,

a) The entire property and control of all petroleum in, under or upon any land is vested in the State, this applies to all land (including land covered by water) which is in Nigeria, under the territorial waters of Nigeria or forms part of the continental shelf or part of the Exclusive Economic Zone of Nigeria[147]

b) Pursuant to the Petroleum Act[148], the Minister is vested with the power to grant an Oil Exploration License, Oil Prospecting License or an Oil Mining Lease and is clearly under a public duty to grant renewal if a request for it is validly made.

c) A license or lease may be granted only to a company incorporated in Nigeria under the Companies and Allied Matters Act or any corresponding law.

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[146] On the other hand, the relationship may last a relatively short time. The modern oil and gas lease may terminate on its first anniversary date if the lessee fails to pay delay rentals or it may last as long as there is production in paying quantities from the property covered by the lease.

[147] Laws of the Federation of Nigeria, (1990) Cap. (51).

[148] Laws of the Federation of Nigeria (1990) Cap. (350)

d) The Minister may advise the President to declare a state of national emergency if the Minister is satisfied that , as a result of the low level of availability of petroleum and petroleum products there is an actual breakdown of public order and public safety in the Federation. The president may on receiving the advice of the Minister declare a state of national emergency under the provisions of the Constitution if he is satisfied that it is necessary to do so.

e) In Nigeria, the three types of licenses are the oil exploration license, oil-prospecting license and oil mining lease.

f) The applicant or holder of the license pays the stipulated fees for the license at the time of application to the Department of Petroleum Resources.

g) The Minister exercises general supervision over all operations carried under the licenses and leases granted under the Petroleum Act, reports annually to the Federal Government on the progress of the oil industry in Nigeria and has access at all times to the areas covered by oil exploration licenses, oil prospecting licenses and oil mining leases for the purpose of inspecting the operations conducted therein and enforcing the provisions of the Petroleum Act and any regulations made thereunder and the conditions of any licenses or leases granted under the Act or under any corresponding law for the time being in force in Nigeria.

h) The Minister may by notice in writing require the holder of a license or lease granted under the Petroleum Act or any contractor working for the holder to appear before him at a reasonable time and place to give such information as he may require about the operations being conducted under the license or lease and every person so required to appear shall be legally bound to comply with the notice and give the information.

i) The Minister may direct in writing the suspension of any operation where in his opinion has contravened the provisions of the Petroleum Act or any regulations made thereunder[149].

j) In Nigeria, the mode of operation of the Joint Operating Agreement and the farm out Agreements is very similar to that of the United States.

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[149] Laws of the Federation of Nigeria,(1990) Cap. (350)

CONCLUSION

A comparison of granting procedure of licenses and leases in the two jurisdictions (i.e Nigeria and the United States) has helped one to determine how the two jurisdictions can benefit from one another.

In Nigeria, since the Minister is the major controlling factor of the grant of the leases, one can say that this absolute control by the Minister may result in the abuse of his ministerial powers, thereby granting to unqualified persons or oil corporations the licenses and leases, and the issue of favoritism may also arise, as one cannot determine the yardstick for the grant of such license.

It is inevitable that some applicants of these licenses will continuously be rejected by virtue of the fact that the Minister prefers some to the others even if they have prepared their application in the appropriate way and paid the fees accordingly.

Furthermore, the Minister may not be able to evaluate the fair market value of the petroleum acreages, there may be a lack of transparency and arbitrariness in allocation of acreages, and at the end of the day, the government may not be able to attract truly competitive offers from Multinational Corporations.

In the United States, the fact that some of these procedures vary according to state may be classified as an advantage and equally as a disadvantage.

It may be seen as an advantage because each state has its rights; powers, procedures and each of them can determine how they want to operate. It can also be a disadvantage because initially, it may be confusing to other operators in other jurisdictions who are interested in investing in the oil and gas business within the United States. Because of the fact that each state has its law, which varies from one state to another, the foreign investor has to meet different requirements as stipulated by each state of his interest. The foreign investor has to adjust to the U.S System and it may take a while before he can have a good understanding of the system. The advantage here is that since the oil and gas lease in the United States is a business transaction and is at the sole discretion of the landowner, both the landowner (who is interested in making profit and the oil company who is interested in exploring oil and gas on the landowners' property are gaining some satisfaction which is known as profit since the oil company will make payment to the landowner in respect of the land which is leased out.

In conclusion, I am of the opinion that the Nigerian Petroleum law should be modified and that the United States law will be relevant to its modifications. Firstly, that the oil and gas lease be structured as a business transaction to enable both parties i.e. the landowner and the oil company, generate maximum profit and satisfaction for each other.

Secondly, that there be a direct relationship between the landowner and the oil company, such that the landowner who receives royalty or bonus from the oil company as a result of the exploration or development done on his land and based on his agreement with the oil company will not represent to the oil company an unending list of requests outside their agreement nor take undue advantage of the oil company;

Thirdly, the negative social, economic and environmental effects of oil and gas development in Nigeria and the ongoing problems stirred up by the indigenes of the oil-producing communities will be eradicated.

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