Unitisation in the Oil and Gas Industry in Nigeria: New Regulations

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Introduction

In recent times, unitisation has been adopted as a mode of resolving conflicting interests between different parties engaged in oil exploration where a single petroleum reservoir straddles neighbouring leased areas each held by different licensed holder. Unitisation in the oil and gas industry refers to a process where separate oil or gas fields are brought together under a single management structure to enhance resource recovery and economic efficiency.

Unitisation strives to maximise the extraction of natural resources while reducing the environmental impacts and economic redundancies associated with drilling multiple wells in adjacent reservoirs. By joining forces, operators can pool their resources, share costs, and develop collective strategies to optimally exploit overlapping reservoirs. This can lead to higher yields and more sustainable resource management practices, which have become increasingly important in an increasingly environmentally-sensitive world grappling with climate change. In essence, unitisation transforms what could be disjointed, competitive producer behaviours into collaborative operations focused on overall resource maximisation. In Nigeria, where oil and gas play an essential role in the economy, effective unitisation can enhance both production levels and economic returns.

The lawmakers and the regulators have since provided the much-needed legal framework that guides unitisation in Nigeria. The Nigerian Upstream Petroleum Regulatory Commission (the "**Commission**") on May 24, 2023 released the Nigerian Upstream Petroleum Unitisation Regulation (the "**Regulations**"). The Regulation is made pursuant to the powers conferred on the Commission by sections 10(f) and 80(9) of the Petroleum Industry Act (the "**PIA**"), 2021.

This article seeks to discuss the concept of unitisation and highlight some of the key provisions in the Regulations. We believe that the Regulations are a step in the right direction for unitisation in Nigeria, providing a much-needed legal framework. However, we have identified some gaps that need attention. For instance, the Regulations do not address potential anti-competition issues that may arise from unitisation or the fate of a party that loses its petroleum licence while still having obligations under a unitisation agreement.

Concept of Unitisation

The need for unitisation arises primarily from the physical nature of oil and gas reservoirs. Reservoirs do not adhere to legal boundaries; hence, when pressures and geological formations continue beneath multiple properties, inefficient production can occur if each entity operates independently. This situation can lead to phenomena such as 'drainage', where one party extracts oil or gas at a rate that diminishes the resources available to neighbouring stakeholders. The term "drainage" refers to the unintentional extraction of hydrocarbons that would have belonged to another party if the reservoir had been developed jointly.

Moreover, unitisation fosters the likelihood of maximising recovery from a reservoir. Enhanced oil recovery techniques, which are often expensive and complex, benefit significantly from coordinated efforts. A unified development strategy enables the sharing of resources and knowledge, which is instrumental in optimising recovery methods; for instance, using water flooding or gas injection to maintain reservoir pressure can only be effectively implemented through cooperation.

The process of unitisation typically begins with the identification of reservoirs that warrant a collective approach to development. Once detected, stakeholders typically engage in discussions to negotiate the terms of unitisation. Key to this process is the formation of a "unit agreement" or "unit operating agreement", which sets out the governance structure, operational protocols, revenue-sharing mechanisms, and the roles of each party involved. This agreement often requires extensive legal deliberation, as it must adhere to both local and international laws and regulations. Gathering geological and engineering data becomes an essential aspect of the negotiation process. Reservoir

studies often involve conducting detailed seismic surveys and assessments of production history to ascertain the most effective methods for extraction. Such technical evaluations guide the stakeholders in drafting a coherent operational plan within the unit agreement. After an agreement is reached, operational procedures commence, which requires substantial collaboration among all parties. This collaborative method is not only beneficial from a resource extraction perspective but is also a vital tool for mitigating potential disputes. Clear communication and regular updates throughout the life of the agreement can help manage relationships between stakeholders.

One of the major reasons for unitisation is to avoid the effects of the rule of capture which states that oil and gas become the property of the owner of the land on which they are recovered by lawful drilling or other operations, regardless of whether they might have migrated from their original position under the land of another.[1] The rule of capture was applied in the American case of *Brown v Spilman,* 155 US 665 (1895) where the Supreme Court held that where a landowner drills into his own land and in the process taps oil and gas deposits from an adjoining land belonging to his neighbor, so that the resources flow into his well, he automatically becomes the owner of the resources captured.

Also, in *Barnard v. Monongahela Natural Gas Company*[2] where the Monongahela Natural Gas Company (the "**Company**") leased oil and gas drilling operation rights from two adjacent landowners under separate leases. The Company drilled a well in close proximity to the property of one of the landowners that was estimated to extract gas from an area that 75% under the land that was belonging to the other landowner. The landowner applied to the court for an injunction restraining the Company from depleting the reservoir however, the court thus "*[E]very landowner or his lessee may locate his wells wherever he pleases regardless of the interests of others. He may distribute them over the whole farm or locate them only on one part of it. He may crowd the adjoining farms so as to enable him to draw the oil and gas from them. What can his neighbor do? Nothing.*"

The rule of capture, being a common law doctrine[3], forms part of the sources of law in Nigeria and thus applies in Nigeria by virtue of the Interpretation Act Cap.123, Laws of the Federation of Nigeria, 2004[4], which incorporates applicable common law principles into Nigerian law. However, the application of the rule of capture in Nigeria is subject to the provisions of the 1999 Constitution of the Federal Republic of Nigeria as amended (the "**1999 Constitution**") and the PIA which vests the ownership and control of petroleum resources in the Federal Government of Nigeria.[5]

The implication of applying the rule of capture is that it will ultimately result in the competitive accelerated drilling by all parties who have rights to different oil blocks which lie over the common reservoir which will impair the maximum recovery of the oil fields which is the primary interest of the state. Due to the forgoing reasons, unitisation has become key to solving issues that may arise between parties drilling a common reservoir.

One of the key considerations before entering into a unitisation agreement is the contractual challenge it poses. This arises because a unitisation agreement involves two or more separate entities or parties that existed independently before the agreement came into force. These entities are typically engaged in oil exploration and production under pre-existing arrangements such as joint ventures or production sharing contracts or licences granted by the State. Consequently, unitisation agreement is typically built upon a network of pre-existing agreements that precede it.

The unitisation agreement may introduce complexities that could adversely affect the ability of the parties to fulfill their obligations under these prior agreements either to the State or to third parties.

[1] Terence Daintith, "The Rule of Capture: The Least Worst Property Rule for Oil and Gas" (February 2010) https://academic.oup.com/book/9143/chapter-abstract/155751260?redirectedFrom=fulltext accessed September 28, 2023.
[2] 216 Pa 362 (1907).
[3] *Acton v. Blundell,* 12 Mees. W. 324, 354, 152 Eng. Rep. 1223, 1235 (Ex. Ch. 1843).
[4] Sec. 32(1).
[5] Sec. 44(3) 1999 Constitution; sec 1(1) PIA.

These difficulties can impact on the performance of obligations under production-sharing arrangements, operational licences or other contractual commitments. As a result, it is crucial to conduct thorough legal due diligence on the prior material contracts of the parties involved. This ensures that the parties will be able to meet their obligations under the unitisation agreement without breaching or impairing their responsibilities under pre-existing agreements.

Unitisation under the Petroleum Industry Act (2021): Two Nigerian Owners

The PIA mandates a licensee or lessee (the "**Discovering Party**") to promptly notify the Commission of any petroleum reservoir which extends beyond the boundaries of its licence to the lease area. The notification shall be followed by a full report to the Commission within 60 days, stating, for each straddling petroleum reservoir, the following information: (a) a detailed report relating to the parcel and sub-parcel in which the exploration well is located and, where the discovery was made; (b) the studies showing the existence of each petroleum reservoir that was identified; and (c) any other relevant information as may be necessary to validate a petroleum discovery in the licence or lease area[6].

Further to such notification, the Commission may for the purpose of ensuring optimum recovery of petroleum from a petroleum reservoir, require all petroleum operations relating to commercial discovery to be carried out by a licensee or lessee on the basis of a unitised development of the applicable commercial discovery where[7] (a) the petroleum reservoir covered by an area to which a licence or lease relates extends beyond the boundaries of such area into an area to which another licence or lease relates and in respect of which a different person is the licensee or lessee, and (b) at least one licensee or lessee has made a declaration of a commercial discovery.

The Commission upon receipt of a notification shall require the licensee or lessee into whose licence or lease area (the "**Adjoining Party**"), a reservoir extends to confirm if the reservoir straddles. The Adjoining Party may provide the confirmation by either carrying out exploratory activities, including drilling a confirmatory well or provide a rebuttal based on the existing information available to the Adjoining Party[8]. The Regulation do not state any deadline for filing or stipulate any filing fee or costs.

Where the Adjoining Party presents a rebuttal, the Commission shall make a determination based on all the information provided by the parties on whether or not the reservoir straddles, the two blocks and the Commission`s decision shall be final[9]. However, where the result confirms that the reservoir straddles, the Commission shall direct the parties to enter into a unit agreement to develop the petroleum reservoir as a unit, within a period of time to be determined by the Commission which shall not be less than two (2) years[10]. By the Regulations, the unit agreement to be executed by the parties are the a "Pre-Unitisation Agreement" prior to executing a unitisation agreement, and the Unitisation Agreement for the joint development of the reservoir. The parties may also execute a Unitisation and Unit Operating Agreement where the straddling reservoir is a "Brown-Brown"[11] (i.e. where there has been prior production in the straddling reservoir by each of the licensee prior to unitisation). All these agreements shall be subject to the approval of the Commission before execution by the parties.

The Pre-Unitisation Agreement addresses those matters that must be agreed for the preliminary activities to begin such as the initial equity interests of the parties, the appointment of the unit operator who will conduct the pre-unitisation operations, and the establishment of an operating committee to approve the pre-unitisation operation[12]. It is important to note that the interests of the parties contained in the Pre-Unitisation Agreement will not necessarily be reflected in the subsequent

[6] S. 4(2) Reg.
[7] S. 80 (1) and (2) PIA.
[8] S. 5 (2)(a)(b) Reg.
[9] S. 5(5) Reg.
[10] S. 80 (3) PIA.
[11] S. 6 Reg.
[12] Nina Howel, " Unitisation Agreements: key issues for drafting, reviewing and negotiating" [Link]

Unitisation Agreement. This is because the parties will find out more about the reservoir through geological and reservoir engineering studies which will be undertaken thus, there may be subsequent redeterminations.

The Unitisation Agreement on the other hand usually contains the terms for the formation of the unit, appointment and removal of the unit operator, the authority and duties of the unit operator and conduct of unit operations, the formation of work programmes and budgets, including invoicing and expenditure principles, and decommission[13]. The key consideration of the parties before the execution of the Unitisation Agreement is to determine: (a) the "unit area"- which is the surface area of the reservoir based upon seismic studies and exploration and appraisal drilling; (b) the "tract"- which is the portion of the unit area underlying the licence which is owned by either of the parties; and (c) the "tract participation" – which is the interest each of the parties within the reservoir which is allocated to a tract[14].

In the event that the parties are unable to reach an agreement to enter into a unitisation agreement within the prescribed twelve (12) months, the Commission is empowered to issue a directive to the parties to jointly appoint an independent consultant to develop the conditions of the unit agreement[15]. Where the parties fail to appoint the independent consultant within ninety (90) days of the directive by the Commission, the Commission shall appoint an independent consultant for the parties.[16]

Special Situations: Only One Nigerian Owner

The law further envisages a situation where a petroleum reservoir extends beyond the boundaries of a licensee or lessee into an adjacent area which is not covered by a license or a lease. In such a situation, the Regulations gives the licensee or lessee the right to apply for an extension where such licensee or lessee has made a commercial discovery in relation to such reservoir and the Commission may require the licensee or lessee [17] (i) to make an application to cover the area and may approve the application where the applicant fulfills conditions prescribed by the Commission; or (ii) conduct a bid exercise pursuant to the Act for the area not covered by a license or lease that the reservoir straddles[18].

Finally, where the straddling reservoirs extend outside the territory of Nigeria, unitisation will be carried out in accordance with the applicable international agreements or treaties to which Nigeria is a party, or in the absence of such international agreements or treaties, based on consultations with competent authorities of such other jurisdiction[19]. An example of such treaty is the Treaty between the Federal Republic of Nigeria and the Democratic Republic of Sao Tome on the Joint Development of Petroleum and Other Resources, in Respect of Areas of the Exclusive Economic Zone of the Two States (the "**Treaty**") which was signed on February 21, 2001 and came into force on January 16, 2003. The Treaty provides for the joint development of transboundary resources within a maritime zone where the two countries have overlapping claims with respect to their exclusive economic zone. It further set up a joint development zone for the joint exploration and exploitation of petroleum and fishing resources in the overlapping areas.

Gaps in the Regulation?

Although the Regulations have provided a much-needed legal framework for unitisation in Nigeria`s oil and gas industry, certain key issues remain unaddressed. One of such issues is the potential for anti-competition conduct arising from unitisation. By its nature, unitisation involves the collaboration of

[13] Andrews Kurth LLP "Unitisation- The Oil and Gas Industry`s Solution to One of Geology`s Many Conundrums" (August 2014) http://documents.lexology.com/279fe7de-a081-4b57-84ea-8821421812f4.pdf.
[14] *Supra.*
[15] S. 80(3) and(6) PIA.
[16] S. 80 (6) PIA, s 11 Reg.
[17] S 80(7) PIA, s 7 Reg.
[18] S. 7 Reg.
[19] S. 14 Reg.

multiple parties or entities to jointly develop and produce oil and gas from a shared reservoir. While this promotes operational efficiency and resource optimization, it can also inadvertently lead to practices or agreements that restrict competition, such as market allocation, price-fixing, or monopolistic control over shared resources. An illustrative example, on how such collaboration could raise anti-trust concerns was demonstrated in the case of *United States v. SG Interests Ltd I et al*[20]. In this case, the United States government filed a civil anti-trust action against the defendants, and it was found that the defendants who were supposed to be competing bidders, had entered a memorandum of understanding which facilitated a scheme to jointly bid for federal oil and gas leases. This collusion ultimately resulted in the government receiving substantially less revenue than it would have in a competitive bidding process, thereby violating anti-trust laws.

This case underscores the need for robust mechanisms to address potential anti-trust risks associated with collaborative agreements like unitisation. While unitisation is critical for optimizing Nigeria`s oil and gas resources, it is equally important to ensure that such arrangements do not contravene principles of fair competition or undermine market integrity.

Additionally, the Regulation fail to address circumstances where a party to a unitisation agreement loses its licence either due to expiration or termination, rendering the party incapable of fulfilling its obligations under the agreement. This glaring omission leaves the remaining party or parties vulnerable, exposing them to financial, operation, and legal risks without clear recourse.

Furthermore, the Regulation`s stipulation that the Commission shall have the final say in determining whether or not a reservoir straddles raises serious concerns about arbitrary administration. By vesting this power exclusively in the Commission, the Regulation appears to oust the jurisdiction of the courts contrary to the provisions of section 6 of the 1999 Constitution.

Conclusion and Recommendations

It is evident that the rule of capture is obsolete and no longer in tune with the present-day commercial realities, unitisation presents a better approach in solving the challenges posed by straddling reservoirs. The new Regulations are welcome for bringing a large measure of much-needed clarity to the law. However, even with the legal framework on unitisation provided by the lawmakers and regulators, there are still some challenges with unitisation which the laws do not address. It is our recommendation that:

A. The potential anti-competition risks highlight the need for additional regulatory oversight to ensure that unitisation agreement align with competition laws and do not create unfair market conditions. Addressing these issues will be critical to maintaining a balance between collaboration and market integrity in the oil and gas industry.

B. Amend the Regulation to provide clear guidelines on how the obligations of a party to a unitisation agreement are to be handled in the event of licence expiration, termination or revocation. The amended regulation may provide for automatic reallocation of interests, replacement of defaulting parties, state intervention to protect the remaining parties and ensure continuity or mandate that parties maintain financial guarantee or insurance to cover potential defaults arising from the loss of a licence.

C. Parties should be allowed to seek judicial redress in cases of dissatisfaction regarding the Commission`s determinations, ensuring accountability and constitutional compliance.

[20] 1:12-CV-00395 (D. Colo.2012); https://www.justice.gov/atr/case-document/file/510586/download.

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