

"Pre-emptive rights in Oil and Gas Operating Agreements: Desirability in the Nigerian context"

INTRODUCTION There are various contractual arrangements that govern the exploration, production and exploitation of petroleum resources. These include, the Joint Venture Operating Agreement, Production Sharing Contract, and the Service Contract.

One of the very important rights found in these operating agreements is the right of a partner to transfer its interest in the joint venture. Where a party to the venture is freely allowed to transfer its interest to another party, it could bring about serious consequences to the joint venture. As a result, in order to prevent frivolous transfer of JV interests to third parties without the financial or/and technical capacity and to increase the likelihood of benefitting more from the venture, the parties usually include a pre-emptive rights clause. This gives them a preferential right to buy out the interest of a divesting partner.

PRE-EMPTIVE RIGHTS

A pre-emptive right is a concept introduced to protect the interest of existing parties and venture partners. It is a right that prevents a contracting party from assigning all or part of its interest or rights unless other parties to the contract have first been afforded the opportunity to purchase such interest. Industry experts believe that the reasoning behind this arrangement is that, existing parties to the joint venture who have spent resources and expended effort in the exploitation of a license should have the opportunity of benefiting first from the license or award as the case may be, before a third party seeking to derive interest under the license.

There are certain benefits that accrue as a result of the inclusion of this right. The main benefit is that it allows the partners to a joint venture maintain control of the venture, which is achieved by being able to control participation by new venture partners. Parties to a joint venture should have the ability to prevent a new comer to the venture from participating if it does not meet certain requirements. Factors such as the requisite financial and technical capacity, and sometimes non-tangible considerations like business philosophy, good will and past relationship may amount to considerations that existing parties deem necessary in order to be effective.

Following from the above, the inclusion of a preemptive clause in oil and gas operating agreements is, from the perspective of the indigenous oil companies in Nigeria, favourable to the extent that it retains the operations and control of oil blocks in the hands of indigenous oil companies, increasing their prominence in the oil and gas sector.

Existing licensees also have the advantage of being able to monitor wealth transfer in the venture and it prevents a split transfer of interest, which may affect the voting pattern and make it more difficult to make decisions. After laboring on an oil field, parties to a joint venture view this right as an opportunity to increase their stake in the joint venture and also to increase their benefit. This is only fair.

However, there remain some disadvantages of this pre-emptive right. It is the view of many that these pre-emptive rights clauses constitute an unreasonable fetter on a party's right to alienation, which is likely to make the interest or less worth to the market. With time, the rights in a joint operator are now viewed more as a proprietary interest and not just a contractual right that is dependent on liquidity and is easily transferable. The existence of this clause in certain circumstances serves as a clog on transferability of interest, which may constrain parties and force them to do away with their interests in a manner that may not necessarily fulfill their intentions.

Perhaps the main argument against the inclusion of preemptive rights clauses is that the transfer restriction mechanism could be a restraint to the commercial viability of the asset. For example, in a recent divestiture conducted by a leading IOC, at the

completion of the divestment process, NNPC suddenly chose to enforce its preemptive right under the PSC. As a result, the winning oil company had to withdraw from the process and it stands to lose N129million lodged in escrow. As a response to this problem, other jurisdictions have slowly done away with this clause, and instead employed practical methods of drafting out of pre-emptive rights clauses, which include various sale arrangements that will transfer the right without triggering the pre-emption provision.

As a result of the restraint to commercial viability that the inclusion of preemptive rights causes, interested parties may be discouraged from making moves to buy into existing licenses because it is fraught with uncertainties as existing awardees/licensees wait until late in the negotiation process before indicating their intention to exercise their pre-emptive right. These uncertainties also make it harder for new players to enter into the market and as such reduce the flow of foreign investment into the industry and consequently the country. This can conveniently be attributed to the delay with which the NNPC has exercised its pre-emptive rights in several of the oil blocks of which it is a joint partner.

CONCLUSION

In conclusion, the inclusion of a preemptive right clause, offers some comfort to the parties to a joint venture. It gives parties some assurance of control over their interests are safe. However, it seems that the disadvantages outweigh the advantages in light of prevailing investment climate and circumstances. Perhaps if preemption clauses could be re-drafted in a way that it did not unreasonably fetter parties' rights, it would do more good.

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