

## Overview of the Nigerian Petroleum Industry Bill

The Petroleum Industry Bill (the "PIB" or the "Bill") is perhaps the most talked about piece of legislation in Nigeria given the far reaching reforms which it proposes to an industry which is the single most significant contributor to the national economy. Originally introduced in December 2008, the bill has undergone numerous revisions and has been the subject of intense debate.

On 18 July 2012 President Goodluck Jonathan presented a new version of the PIB to the seventh session of the National Assembly for consideration and enactment.

This article considers the history of the Bill and provides an overview of its salient provisions.

### THE EVOLUTION OF THE CURRENT VERSION OF THE BILL

In an attempt to restructure the oil and gas industry, the Oil and Gas Sector Reform Implementation Committee (OGIC) was inaugurated on 24 April 2000 under the chairmanship of Dr. Rilwanu Lukman (then serving as the Presidential Adviser on Petroleum and Energy). The OGIC was charged with the task of making recommendations for a far reaching restructuring of Nigeria's oil and gas industry. The recommendations of OGIC included a proposal to separate the commercial institutions within the industry from the regulatory institutions.

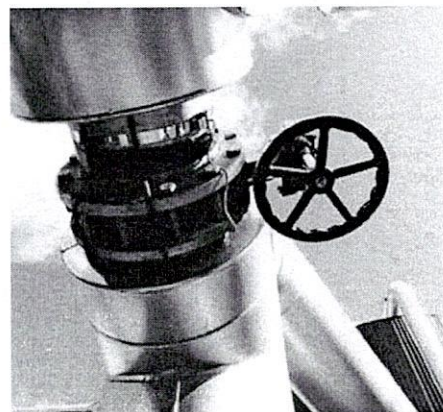
In 2007, the Federal Government of Nigeria introduced the National Oil and Gas Policy and re-constituted OGIC to make recommendations towards the emergence of a new institutional framework to govern the operations of the oil and gas industry, including the emergence of a new National Oil Company, new regulatory bodies and a new national directorate, for a more effective policy formulation for the industry.

Further deliberations of OGIC produced the Lukman Report of 2008 which recommended a new regulatory and institutional framework that, when implemented, would guarantee greater transparency and accountability. This report formed the basis for the first PIB that was submitted in 2008 as an Executive Bill.

Among the salient features of the original version of the PIB were the:

- unbundling and commercialization of the Nigerian National Petroleum Corporation (NNPC);
- transformation of the existing joint ventures between multinational oil companies and the NNPC;
- deregulation of the downstream sector;
- creation of new regulatory bodies; and
- introduction of a new fiscal regime that sought to increase overall government take.

Expectedly, the prospect of a new fiscal regime which almost certainly would guarantee increased government take elicited strong opposition from the International Oil Companies which argued that the Bill would create a harsh environment that would materially change the economics of new and existing investments. Initial reactions to the Bill prompted intense discussions among stakeholders in the industry and signaled the commencement of a process of multiple revisions of the Bill in an attempt to produce an acceptable draft. This revision process culminated in a proliferation of diverse and irreconcilable versions of the Bill. The existence of different versions of the Bill together with preparations for the general elections in the 2nd quarter of 2011 contributed to the inability of the last session of the legislature to enact the Bill into law.



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The resurgence of the Bill can be traced to a number of factors: the gradual cessation of investments in the sector as a result of uncertainty regarding the fiscal provisions of the Bill and their potential impact on the industry, the emergence of competing petroleum investment opportunities in other sub-Saharan African countries such as Ghana, Angola, Sao-Tome and Principe, and more recently, the attempt by the Nigerian Government to deregulate the downstream industry in January 2012 which led to an increase in fuel prices. In response to the increase in fuel prices, organized labour under the umbrella of the Nigerian Labour Congress and the Trade Union Congress had called out its members on a six-day nationwide strike which paralysed economic activities. The Federal Government as part of efforts to contain the strike, committed to expedite the reform of the oil and gas industry by, among other things, fast-tracking the passage of the PIB. Subsequently, the Federal Government inaugurated a Special Task Force with responsibility to produce a harmonized version of the Bill which would be re-presented to the legislature for passage. The current Bill which has now been submitted to the legislature is believed to be largely the product of the work done by the Special Task Force and its technical committees.

## OVERVIEW OF THE PIB

The PIB seeks to revise, update and consolidate existing petroleum legislation in Nigeria including existing legislation on the taxation of upstream petroleum operations. The objectives of the Bill are stated to include:

- creating a conducive business environment for petroleum operations;
- enhancing exploration and exploitation of petroleum resources for the benefit of Nigerians;
- optimizing domestic gas supplies particularly for power generation and industrial development;
- establishing a progressive fiscal framework that encourages further investment in the petroleum industry while optimizing the revenue accruing to the Government;
- establishing commercially oriented and profit driven oil and gas entities;
- deregulating and liberalizing the downstream petroleum sector;
- creating efficient and effective regulatory agencies;
- promoting openness and transparency in the industry; and
- encouraging the development of Nigerian content.

To achieve these objectives the Bill provides amongst other things for:

- the restructuring or reorganisation of industry institutions and the regulatory framework;
- a new fiscal regime for upstream oil and gas production;
- allocation of Domestic Gas Supply Obligations to licensees; and
- deregulation of the downstream sector.

Before undertaking a brief discussion of each of the four broad objectives highlighted above, we will pause to say a few words about one of the stated objectives of the Bill, namely, the promotion of openness and transparency in the oil and gas industry.

The need for openness and transparency in the administration and management of Nigeria's vast crude oil and gas reserves cannot be overstated. As such, the provisions of the PIB which declare that "*the grant of a petroleum prospecting licence or a petroleum mining lease ... shall be by open, transparent and competitive bidding process conducted by the Inspectorate*" will be largely viewed as positive by all stakeholders. It will seem however that the efficacy of these provisions is immediately diluted by the subsequent provisions which empower the President "*to grant a licence or lease under this Act*" without expressly subjecting the President's powers in this regard to the requirement of an open and competitive bidding process. If these provisions are intended to empower the President to make the so-called *discretionary grants of petroleum licences and leases*, then if passed in its current form, the PIB will, arguably, have substantially failed in its objective to promote openness and transparency in the Nigerian oil and gas industry.

## THE INSTITUTIONAL AND REGULATORY FRAMEWORK UNDER THE PIB

As under the current regulatory regime, the Minister of Petroleum Resources (Minister), (a member of the federal executive appointed by, and holding her position at the pleasure of, the President) is declared in the PIB to "be responsible for the co-ordination of the activities of the petroleum industry" and is empowered to "exercise general supervision over all operations and all institutions in the industry". In addition, the PIB proposes the establishment of the following regulatory bodies, institutions and funds:

NAME	FUNCTION/PURPOSE
<b>Petrochemical Technical Bureau</b>	To provide technical support to the Minister of Petroleum Resources on matters relating to the petroleum industry.
<b>Upstream Petroleum Inspectorate</b>	To administer and enforce policies, laws and regulations relating to all aspects of upstream petroleum operations and to issue and administer licenses and leases in the upstream sector.
<b>Downstream Petroleum Regulatory Agency</b>	To administer and enforce policies, laws and regulations relating to all aspects of downstream petroleum operations and to issue and administer licenses in the downstream sector.
<b>Petroleum Technology Development Fund</b> ( <i>already in existence</i> )	To provide scholarships, bursaries and endowments for the training of Nigerians who will qualify as graduates, professionals, technicians and craftsmen in the fields of engineering, geology, science and management and other related fields in the petroleum industry.
<b>Petroleum Equalisation Fund</b> ( <i>already in existence</i> )	To receive net surplus revenues from petroleum products marketing companies and hold such funds in trust for the reimbursement of companies who have suffered loss solely as a result of sale of petroleum products at uniform benchmark prices throughout the country.
<b>Petroleum Host Communities Fund</b>	To receive on a monthly basis from upstream petroleum producing companies, sums equalling 10% of their net profits and to utilise the funds for the development of the economic and social infrastructure of communities within the petroleum producing areas.
<b>National Petroleum Assets Management Corporation</b>	To acquire and manage investments of the Government of Nigeria in the upstream petroleum industry.
<b>Nigerian Petroleum Assets Management Company Limited</b>  (a subsidiary of the National Petroleum Assets Management Corporation to be incorporated as a company limited by shares under the Companies and Allied Matters Act)	To take over certain assets and liabilities of the NNPC including: <ul style="list-style-type: none"> <li>i. unincorporated joint ventures;</li> <li>ii. bonds, loans, financing arrangements, joint operating arrangements;</li> <li>iii. litigation and staff</li> </ul>
<b>National Oil Company</b> (to be incorporated as a public company limited by shares under the Companies and Allied Matters Act )	To take over certain assets currently held by NNPC on behalf of the Government not including interests in unincorporated joint ventures and assets held by the National Gas Company. .
<b>National Gas Company Plc.</b> (to be incorporated as a public company limited by shares under the Companies and Allied Matters Act )	To take over certain assets held by NNPC on behalf of the Government not including interests in unincorporated joint ventures and assets held by the National Oil Company.



## FISCAL REGIME UNDER THE PIB

Under the current regime, companies and entities engaged in upstream petroleum operations are subject to petroleum profits tax pursuant to the Petroleum Profits Tax Act (PPTA) while other companies (including those engaged in downstream petroleum operations) are subject to companies income tax pursuant to the Companies Income Tax Act (CITA). The current rate of petroleum profits tax is 50% for operations in the deep offshore and inland basin and 85% for operations onshore and in shallow waters.

The Bill proposes to replace the existing petroleum profits tax with a Nigerian Hydrocarbon Tax (NHT) at the rate of 50% for petroleum operations onshore and in shallow water fields and 25% for petroleum operations in deepwater, bituminous and frontier acreages. In addition to NHT, the Bill also proposes companies income tax at the rate of 30% on upstream petroleum operations (which under the existing regime are not subject to companies income tax).

To achieve the new fiscal regime, the PIB proposes a repeal of the PPTA and amendments to the CITA to enable its application to the operations of upstream petroleum companies.

Other significant aspects of the new fiscal regime proposed by the PIB include:

- i. the introduction of a general production allowance (GPA) claimable by a company which has executed a production sharing contract (PSC) with NNPC. Under the current regime, an oil producing company which had executed a PSC with NNPC *prior to 1 July 1998* is entitled to claim an investment tax credit (ITC) at the rate of 50% of qualifying capital expenditure (QCE) incurred by that company wholly, exclusively and necessarily for the purposes of its petroleum operations while an oil producing company which executed a PSC with NNPC *after 1 July 1998* is entitled to claim investment tax allowance (ITA) also at the rate of 50% of QCE. The difference between ITC and ITA is that while ITC offers a dollar for dollar credit which directly reduces the tax payable, ITA operates to reduce taxable profits before the tax rate is applied to determine the tax payable. The PIB now proposes to replace both ITC and ITA with GPA. Given that the GPA is intended to, much like the current ITA, reduce assessable profit (and not the tax payable), it is likely to impact more adversely on the take of PSC Contractors in the pre-1 July 1998 PSCs.
- ii. while the ITC and ITA are calculated as a percentage of QCE and available throughout the period of petroleum operations, GPA is to be calculated as follows:
  - (a) For onshore operations: the lower of US\$30 per barrel or 30% of the official selling price (OSP) up to a cumulative maximum of 10 million barrels and the lower of US\$10 per barrel or 30% of OSP for volumes exceeding 10 million barrels up to a cumulative maximum of 75 million barrels and then no more.
  - (b) For operations in the shallow water areas: the lower of US\$30 per barrel or 30% of the OSP up to a cumulative maximum of 20 million barrels and the lower of US\$10 per barrel or 30% of the OSP for volumes exceeding 20 million barrels up to a cumulative maximum of 150 million barrels and then no more.
  - (c) For operations in areas with bitumen deposits, frontier acreages and deep water areas: the lower of US\$15 per barrel or 30% of the OSP up to a cumulative maximum of 250 million barrels per Petroleum Mining Lease and the lower of US\$5 per barrel or 10% of the OSP for volumes exceeding 250 million barrels.
  - (d) For companies currently in a PSC with NNPC but which are not currently claiming either ITC or ITA: US\$5 per barrel or 10% of the OSP for all production volumes.
- iii. oil producing companies in joint venture operations with NNPC are not entitled to claim GPA notwithstanding that they are entitled to claim Petroleum Investment Allowance under the current regime.
- iv. the PIB further proposes detailed provisions regarding the entitlement of gas producing companies to GPA.
- v. NHT is not deductible when calculating companies income tax (therefore constituting it as "true tax"). Similarly, the amount of companies income tax paid or to be paid is also not deductible in the computation of NHT.
- vi. unlike under the current regime, interest expense on loans obtained by PSC Contractors to fund petroleum operations will not be an allowable deduction under the PIB.
- vii. all general, administrative and overhead expenses incurred outside Nigeria in excess of 1% of the total annual capital expenditure cannot be deducted in the computation of the adjusted profits of a company under the PIB. Further, 20% of any expense (other than the general, administrative and overhead expenses recoverable to the limit of 1% of total annual capital expenditure) cannot be deducted in computing adjusted profits *except where such other expenditure relates to the procurement of goods or services which are not available domestically in the required quantity and quality and the approval of the Nigerian Content Development and Monitoring Board has been first sought and obtained*. This provision clearly is aimed at promoting local content in the Nigerian oil and gas industry.



- viii. the PIB also proposes to disallow (a) legal and arbitration costs incurred by a company in cases against the tax authorities and the Nigerian Government and (b) costs or fees incurred in obtaining and maintaining a performance bond under a PSC, in the computation of the adjusted profits of a company.
- ix. the PIB proposes to re-enact the current provisions of the law which state that expenditure incurred in the acquisition of rights in or over petroleum deposits will qualify as "qualifying drilling expenditure" for which capital allowance at the appropriate rate may be claimed. In making this proposal, the PIB undermines the contention in certain Government quarters that signature bonus (which is undoubtedly the consideration paid to acquire a right in or over petroleum deposits) is not subject to capital allowance.
- x. the PIB proposes provisions which put it beyond doubt that a PSC Contractor which finances the cost of acquisition of a capital asset is entitled to claim capital allowances on the capital asset. In this regard, the PIB provides as follows: "*Where the production sharing contract between the national oil company and a contractor provides for the contractor to finance the cost of equipment and for such equipment to become the property of the national oil company, the contractor shall be deemed to be the owner of the qualifying expenditure thereon, for the purpose of the claim of capital allowances.*" Indeed, the effect of this provision is that unlike under the current regime where the PSC Contractor and NNPC share in the benefit of capital allowance, only the PSC Contractor will be entitled to capital allowances under the PIB since the "*contractor shall be deemed to be the owner of the qualifying expenditure thereon, for the purpose of the claim of capital allowances*".
- xi. it is proposed under the PIB that all upstream petroleum producing companies shall remit, on a monthly basis, to the Petroleum Host Community Fund (PHC Fund), 10% of net profits from their onshore, shallow water and deep water operations. The PHC Fund is to be utilised for the development of the economic and social infrastructure of the communities in which petroleum operations are conducted. Regarding contributions from operations in the deep offshore, these are to be utilised for the benefit of the littoral states. "Net profit" is defined in the PIB as "*the adjusted profit less royalty, allowable deductions and allowances, NHT and companies income tax.*" Under the current regime, all producing and gas processing companies operating onshore and offshore in the Niger-Delta area are required to contribute 3% of their total annual budget to the Niger-Delta Development Commission Fund (NDDC Fund) pursuant to the Niger-Delta Development Commission (Establishment) Act (NDDC Act). Given that the NDDC Act is not one of the statutes listed for repeal under the PIB, it would seem that the intention is that the obligations to contribute to the PHC Fund and the NDDC Fund would co-exist. The fiscal impact of contributing to the PHC Fund would appear however to be ameliorated by the proposal in the PIB that contributions to the PHC Fund will constitute an immediate credit to a contributing company's total "fiscal rent obligations" which is defined as "*the aggregation of royalty, Nigerian Hydrocarbon Tax and Companies Income Tax obligations arising from upstream petroleum operations*". While the words "*will constitute an immediate credit to a contributing company's total 'fiscal rent obligations'*" suggests that the quantum of a company's royalty, NHT and companies income tax liability will be reduced by the amount of that company's contribution to the PHC Fund, it is not clear that this is what the drafters of the Bill intended. This is because the PIB also proposes that contributions made to the PHC Fund will be an allowable deduction in computing the NHT. It seems quite unlikely that the Government would approve a proposal which allows contributions to the PHC Fund as a deductible item in computing the NHT while also allowing the amount of those contributions to reduce the quantum of fiscal rent of which NHT is a part.
- xii. with respect to royalties, the PIB does not specify new royalty rates, but provides that applicable royalties will be determined by regulations that will be drafted by the Minister after the Bill is enacted as law. However, pursuant to the savings provisions of the Bill, the present rates of royalties (which are charged on a sliding scale and are depth related) will continue to apply pending the issuing of new regulations by the Minister.

#### **DOMESTIC GAS OBLIGATIONS**

The PIB provides that the Upstream Petroleum Inspectorate shall, having regard to the needs of the domestic gas market and in accordance with the National Gas Master Plan, impose Domestic Gas Supply Obligations (DGSO) on lessees. A lessee who fails to comply with its DGSO shall not be permitted to make supplies to gas export operations, and where the lessee only supplies gas to export operations, the lessee shall be directed to suspend operations. This provision, which is directed toward improving Nigeria's perennially poor power system and assisting industrialisation, will be considered by most Nigerians as laudable.

#### **DEREGULATION OF THE DOWNSTREAM SECTOR**

The PIB provides that the pricing of petroleum products in the downstream product sector shall be deregulated to ensure market related pricing, adequate supply and removal of economic distortions. However, although pricing is to be left to market forces, the Bill proposes to safeguard the interests of consumers by providing that the Downstream Petroleum Regulatory Agency shall oversee tariffs for transportation by pipelines, bulk storage for petroleum products and regulated open access facilities. The Downstream Petroleum Regulatory Agency will also be responsible for market monitoring and promotion of competition.

## CONCLUSION

It can hardly be disputed that Nigeria is ripe for a comprehensive review of the legal and regulatory framework applicable to its oil and gas industry. However, if the PIB is to achieve its worthy objectives (which will undoubtedly benefit the Nigerian oil and gas sector) care must be taken by the legislature to ensure that the Government's legitimate interest in seeking a progressive fiscal framework that optimises revenue for the Government is balanced against the equally important objective of ensuring that the Nigerian oil and gas sector remains attractive to both existing and prospective investors. In this regard, the Government will do well to consider and give due regard to the genuine concerns of all stakeholders regarding the potential impact of the fiscal regime proposed under the PIB.

Furthermore, the Government should also give careful consideration to the effect the proposed fiscal regime will have on existing contracts and must be ready to engage in good faith negotiations as may be required (pursuant to the stabilisation provisions of any existing contracts) to counteract the adverse impact of the new fiscal regime. This will be necessary in order to ensure that the Government entity which is the counterparty in these existing contracts is not at the receiving end of a rash of stabilisation claims.

Finally, although the executive arm of the Federal Government has committed to an expeditious passage of the Bill, in order to achieve this, the legislature whose responsibility it is to pass the Bill will have to buy into this commitment and give the Bill the attention which it deserves. In doing so, the legislature must take care not to sacrifice the quality of the final product on the altar of speed.

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