Who is afraid of Nigeria's Petroleum Industry Bill?
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The Petroleum Industry Bill (PIB) has drawn different emotions from the stakeholders since it came into the public domain. The PIB proposes fundamental reforms of the Nigeria's oil industry and is anchored on five major goals namely creation of new regulatory institutions, transformation of upstream contractual agreements, new fiscal regime, downstream sector deregulation, government participation in the industry and transparency in contractual agreements.

However, the scepticism shrouding the provisions of the bill is not helped with the recent media reports that oil companies are threatening to sue the federal government over the Bill’s purported retroactive agenda. The disclosure by the oil companies comes as a volte face to earlier acceptance of the reforms just two years ago. This discontent which appears not limited only to the major oil companies given the other stakeholders’ presentations at the public hearings of July 2009 brings to mind the question: who is afraid of the petroleum industry bill?

The fiscal changes envisaged under the bill are the subject of this article and certainly the major bone of contention between the key players in the industry. Fiscal regimes are expectedly issues of rancour since it affects the bottom-line for both country and company. The bill is in the third reading stage at the National Assembly and yet the discordant tones on this issue puzzle me to wonder if this piece of legislation truly brings answers than questions on the Nigerian oil industry.

Fiscal provisions of the PIB

A brief history of the PIB is important to put our minds in proper perspective. The bill is the brainchild of the Oil and Gas Implementation Committee (OGIC) inaugurated by the Obasanjo Administration in April 2000. The draft bill of the OGIC gazetted in the National Assembly Journal of December 2008 was however subjected to further amendments by the Inter Agency team headed by Tim Okon, NNPC’s Group General Manager on Strategy. The team comprised of Ministries of Petroleum Resources, Finance, Justice, Department of Petroleum Resources (DPR), Federal Inland Revenue Service (FIRS), Revenue Mobilisation Allocation and Fiscal Committee (RMAFC), and the Nigeria Extractive Industry Transparency Initiative (NEITI). These changes introduced by the interagency team go to the fulcrum of the entire controversy surrounding the PIB, particularly the changes on the fiscal terms.

The changes introduced by the interagency team and the source for this write-up essentially restructured the regulatory framework for the oil industry into separate regulators for the upstream, midstream and downstream sectors, introduced fiscal changes for the upstream, provisions for gas utilisation, refining/downstream sector reforms and replaced the joint venture (JV) agreements between NNPC and the producing companies which cover most of Nigeria’s onshore and shallow-water fields with incorporated joint ventures (IJVs). The IJVs as legal entities are capable of raising loans commercially and repay them from generated income. As a result, the IJVs will operate independent of government cash call obligations, a
guaranteed road-map to ending the perennial defaults of NNPC to its cash call commitments.

The PIB introduces higher royalties and increased government take. At present, a standard 20% royalty applies for onshore operations and 18.5% for prospects in swamp/shallow waters (1-100 metres). The rates built on a reducing sliding scale with offshore fields of water depth up to 200 metres attracting 16.67%, 12.0% for 201-500 metres, 8.0% for 501-800 metres, 4.0% for 801-1,000 metres and 0% when the depth exceeds 1,000 metres. Under the fiscal provisions of the PIB, a progressive royalty linked to production rate and oil price is introduced replacing the existing depth-related royalty.

The new royalties based on an aggregate of the royalties applied for production rate and oil prices are also differentiated for oil and gas. Productions in onshore fields below 2,000 barrels per day (b/d) attract 5% royalty rate and rising to 25% for production exceeding 5,000 b/d. The shallow water areas attract 5% on up to 5,000 b/d ranging to 25% on production over 50,000 b/d while deepwater attract 5% on production up to 25,000 b/d and above 50,000 b/d attracts 25%. The price-based royalty ranges on an incremental basis from 0% to 25% starting at $70 bbl with a price cap at $150. Therefore, in case of deep water fields and high oil prices, the maximum royalty accruing to Nigerian government will be 50%. This is certainly a mechanism for the government to capture windfall profits and increase government take on profitable fields front-end.

Similar changes in government take were introduced for the Production Sharing Contracts (PSC). The limit for cost recovery is fixed at 80% of gross production and therefore reducing the 100% cost recovery provided under the 1993 PSCs. Also, the PIB terms substitutes the profit oil split on sliding scale basis in contrast to the 1993 PSCs which gives the oil companies 80% share of profit oil for the first 350m barrels of production with declining share as cumulative production increases. The same applies to the 2005 PSCs using the R-Factor with the initial company share of 70% profit oil split.

The two layers of tax introduced under the PIB, namely the Nigerian Hydrocarbons Tax (NHT) and Companies Income Tax (CIT) are applicable to both JV and PSC operations. NHT replaces the Petroleum Profit Tax (PPT) and is set at 50% for JV, 50% for gas and 30% for PSC while the CIT is introduced for all oil companies at the rate of 30% on net profits. A minimum of 10% withholding tax on dividends and education tax of 2% on revenue existing under the current fiscal regime is retained.

The PIB terms streamlined the NHT by abolishing the investment tax credits, investment tax allowances and the petroleum investment allowance (PIA) uplift on capital expenditures for existing arrangements and replaced them with allowances for small oil fields and new gas finds. It further proposes to disallow interests expense/financing charges and imposes an 80% limit on expenses incurred outside Nigeria for tax deductibility while introducing benchmarking, verification and approval of all costs for tax deduction purposes. The cost benchmarking would be conducted by the regulatory institutions or the National Oil Company (NOC) and the verification and approval process conducted by the FIRS.

Implications of the PIB fiscal terms

The crux of opposition to the PIB is that it will create a harsh environment that would materially change the economics of the existing and new operations particularly in the
deepwater regions. Undoubtedly, the tax changes would instigate an increased government take from an average of 73% to a projected 82% under the PIB terms. This calculation is derived on projections of a mid-size deepwater oil field with production of around 50 million barrels a year and oil price of US$75/bbl. Therefore, the groundswell of opposition to the PIB is not farfetched since the existing arrangements have put the oil companies in advantage positions of reaping greater share from higher production and current high oil prices.

However, a noticeable fact is that the Nigerian fiscal terms are lenient compared to its peers, particularly the countries with the same geological character. For instance, Libya has 93% government take and UAE Abu Dhabi is on an average of 94%. Recent trends in global fiscal terms especially in this era of rising oil prices have built-in mechanisms of increased government share in windfall prices through increased royalty/taxes and linkages of royalty/tax rates to prevailing prices to ensure automatic adjustment of government share to price increases.

The high-cost intensive nature and the complex dynamics of upstream economics, particularly of deep water fields with its high risk frontier explorations are weighted factors in investment decisions for the oil companies. These scenarios are not any different with the Nigerian environment coupled with its peculiar challenges such as the security situation in the Niger Delta, underfunding of JVs and global escalating cost basis. That said, the PIB is laudable for introducing flexibility in government share and providing automatic response to significant oil price movements. It is a trite jurisprudential legal principle that law is an agent of social change and the PIB brings that optimal solution to initiate change in a Nigerian oil industry besotted by lethargy.

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