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Petroleum Industry Act: Nigeria's New Oil and Gas Regulatory Framework

The petroleum industry is the backbone of the Nigerian economy. Currently, it contributes 80% of the revenues of the Federal Government of Nigeria (FGN), accounts for around 90% of foreign exchange receipts but only contributes less than 10% to gross domestic product, largely because only a small part of the oil and gas value chain is domesticated.

The Petroleum Ordinance promulgated in 1889 was the first law to provide the legal basis for the granting of oil exploration rights in Nigeria. However, Nigeria's first concrete petroleum legislation is the Petroleum Act (PA) of 1969, which was enacted 13 years after the discovery of oil in Oloibiri in 1956.

There have been some amendments to the 1969 Petroleum Act and enactments of new petroleum laws to govern different aspects of Nigeria's petroleum industry. However, the enactment of the Petroleum Industry Act (PIA), in August 2021, is the boldest yet since 1969. The PIA either repealed or amended ten existing petroleum laws, and it becomes the principal legislation to govern the Nigerian petroleum industry. The journey of the enactment of the PIA started in 2000 when former President Obasanjo formed the Oil and Gas Reform Implementation Committee (the Committee).

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Olumide Esan

The activities of the committee culminated in the Natural Gas Fiscal Reform bill proposed during President Obasanjo's regime and subsequently as Petroleum Industry Bill (PIB) during the reign of President Yar'Adua. Ever since, the PIB has gone through series of changes until President Buhari assented to it as an act of the National Assembly in August 2021.

Investors in the petroleum industry are generally not motivated to invest in a jurisdiction where there is uncertainty about the fiscal and regulatory environment of the petroleum industry, due to the large capital investments required and relatively long project life cycle. The fact that it took 21 years to enact the PIA made investments in Nigeria's petroleum industry uncertain and less attractive, which is why Nigeria only attracted 3% of the USD70billion dollars in investments made in the African oil and gas industry, between 2015 and 2019.

The enactment of the PIA has lifted the uncertainty surrounding the fiscal and regulatory environment of Nigeria's petroleum industry. Subject to any impact of new energy transition on new investments in fossil fuel, a new wave of Foreign Direct Investment (FDI) is expected in the industry, with the hope that the other industry-related issues, such as infrastructure deficits and security (including crude oil theft) are addressed.

Nigeria has 37 - 40 billion barrels of proven crude oil reserves and 200 - 206 trillion cubic feet (tcf) of gas reserves; at the average daily production rate of 2 million barrels per day (mmb/d) of crude oil and 7.6 billion cubic feet per day (bcf/d) of gas, it will take about 50 years and 75 years respectively to fully exploit our proven petroleum reserves. Given that there are energy transition concerns, fossil fuels may no longer be the primary source of world energy from 2040/2050, which is only about 20 – 30 years away. This, therefore, means that it is best to ramp up our production capacity ahead of transition from fossils to renewables, to fully monetise our petroleum resources to build our public infrastructure and industrialise the Nigerian economy.

Nigeria has the ambition to double its oil and gas production rates. If we get that done, we will cut the production lifetime of our petroleum reserves by half, which helps the nation monetise its reserves before fossils lose economic value significantly. The enactment of the PIA brings us closer to realising these audacious ambitions, but beyond that, we must have addressed other industry issues.

Over the past two decades, more countries, including those in East and Southern Africa, have discovered petroleum reserves in basins such as the East African Rift, increasing competition for FDI with Nigeria. With improved investor confidence expected from the enactment of the PIA, the Nigerian government may consider paying greater attention to ensuring that critical multi-billion dollars Liquefied Natural Gas (LNG) projects, such as Brass LNG and Olokola LNG are commissioned. These projects will enable Nigeria monetise a significant portion of its gas reserves over the coming years.

As a rich gas province, gas may well be Nigeria's saving grace. It is the cleanest fossil fuel, and hence still attractive for investments as part of the energy transition. Unlike oil, which may be subject to quota restriction as part of the OPEC commitments, gas is not subject to OPEC production curtailments. As a resource-rich but energy-poor economy, it is estimated that increasing the domestic gas utilization rate from 1.5 bcf/d to 7.5bcf/d will not only eliminate gas flaring but provide sufficient gas for the gas-based industries, and the power needed for national industrial development. The potential revenue take in form of taxes, royalties and dividends (from projects like Nigeria Liquefied Natural Gas [NLNG] Limited) may ultimately provide the government with the means to deal with some of the economic challenges and bring external borrowings under control.

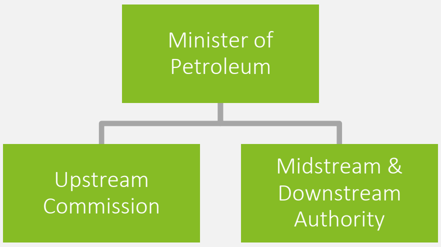
In general, the PIA is a good law and it brings Nigeria closer to achieving its economic and development goals. It is clearly not a perfect law, but the good news is that the gaps may be closed by way of amendments through annual finance acts. These amendments are likely to be largely driven by the advocacy efforts of industry players.

Although the PIA is now a law, it only comes into force on the effective date, which will become know when the FGN publishes it in its gazette. The PIA should have a well-defined transition period with an extended effective/commencement date.

Our PIA newsletter is a series of four issues, this document being the first, and it is focused on chapter 1 of the PIA, analysing the key aspects of the governance of the Nigerian petroleum industry and its institutions. In the subsequent issues, we will analyse the other aspects of the PIA, as summarised below:

Governance and Institutions

Minister of Petroleum and the principal regulatory authorities



Background

Under the PIA, the Minister of Petroleum (MoP) continues to exercise general supervision over the affairs and operations of the Nigerian petroleum industry, as it is obtainable under the pre-existing PA.

The overall governance and institutional structure of Nigeria's petroleum industry is fundamentally different from the pre-existing structure.

We have presented key highlights in the following bullet points:

- Under the PA, the governance and administration of the petroleum industry rest with the MoP. However, over the years, the Minister had traditionally delegated certain functions to the Department of Petroleum Resources (DPR) or its predecessor agencies. The DPR is a government agency within the Ministry of Petroleum which makes it fully dependent and subject to the full control of the MoP.
- The PIA created two regulatory authorities, one for the upstream sector (i.e. Nigerian Upstream Petroleum Regulatory Commission or 'the Commission') and another one for the midstream and downstream sectors (i.e. 'Nigerian Midstream and Downstream Petroleum Regulatory Authority' or 'the Authority').
- DPR, which is currently the principal regulatory agency for the Nigerian petroleum industry, will cease to perform the functions that will be performed by the Commission and the Authority. The MoP may wish to retain the DPR to perform certain ministerial functions, as may be delegated.
- Petroleum Products Pricing Regulatory Authority (PPRA), which is responsible for regulating the prices of regulated petroleum products, will cease to exist, and its functions will be performed by the Authority.

One of the key sources of the Authority's funds is a charge of 0.5% of the wholesale price of petroleum products sold in Nigeria, which is collectable from wholesale customers.

Other key issues and commentary

Public governance and accountability of institutions

1

The PIA empowers the President to appoint the board of directors of the Commission and the Authority, subject to the confirmation of the National Assembly, which essentially allows the Commission and the Authority to be independent of the MoP in the management of their affairs. The independence of the Commission and the Authority from the MoP is expected to improve public governance and fair judgment. However, where the President of Nigeria and the MoP is one and the same person, the benefit of independence of both regulatory agencies may no longer exist.

2

The Commission and the Authority are required to publish their annual budgets and accounts on their websites, which is an attempt to encourage transparency and accountability.

3

The Commission and the Authority are also required to maintain a public register of all licenses issued, which removes the opacity that currently plagues the issuance of licenses, especially in the upstream sector.

Grant and renewal of licenses

The power to issue upstream petroleum licenses/leases rests with the MoP but it must be based on the recommendation of the Commission. However, for midstream and downstream licenses, the Authority is the ultimate approving agency and requires no Ministerial approval.

Funds of the Commission and the Authority

One of the key sources of the Authority's funds is a charge of 0.5% of the wholesale price of petroleum products sold in Nigeria, which is collectible from wholesale customers. This charge makes the domestic sale of petroleum products (including natural gas products) more expensive and adds to the plethora of levies, taxes, and rates payable in the Nigerian petroleum industry.

The Commission has no equivalent funding but has other sources of funding just as the Authority does.

Midstream and downstream gas infrastructure fund

The PIA established the midstream and downstream gas infrastructure fund (the Fund) to make equity investments of government-owned participating or shareholder interests in infrastructure related to midstream and downstream gas operations. The Fund seeks to achieve an increase in domestic gas utilisation and elimination of gas flaring.

The primary source of the fund is a levy of 0.5% of the wholesale price of petroleum products and natural gas sold in Nigeria, collectible from wholesale customers. The 0.5% levy payable to the fund is separate from the 0.5% charge payable to the Authority.

The 0.5% levy could potentially apply twice along the gas value chain; first on the local sale of natural gas at the upstream, which is a crude resource, and secondly, on sale of petroleum products, which may be natural gas liquids or liquified petroleum gas extracted from the processing of natural gas at the midstream. The imposition of this levy appears to be counterproductive as it makes domestic petroleum products, especially gas products, more expensive and has the tendency to slow down the drive towards increasing domestic gas utilisation. Additionally, the levy has not been factored into the gas pricing model, which makes it a burden on investors that cannot be passed on to customers.

Gas flaring penalty payable to the Commission shall be transferred to the Fund for environmental remediation and relief of the host communities of the settlor on which the penalty is levied. The Act is silent on the frequency of transfer of gas flaring penalty monies from the Commission to the Fund, which may lead to disputes in the event the Commission and the Authority maintain different views on the subject.

Repositioning of NNPC

Background

The Nigerian National Petroleum Corporation (NNPC) became a commercialized corporation in 1988, 11 years after it was created by the NNPC Act. It has always been operated as a profit-oriented state oil company, with obligations to pay taxes and royalties.

However, over the life of NNPC as a commercialized entity, the corporation has generally been a net loss-making entity. For the first time in a while, NNPC recorded a profit before tax (PBT) of ₦287Billion for the 2020 financial year as recently disclosed by President Muhammadu Buhari.

Key issues

Incorporation and governance of the successor NNPC entity

1

Within 6 months from the commencement of the PIA, the MoP is required to incorporate Nigerian National Petroleum Company Limited (NNPC Ltd), under the rules of the Corporate and Allied Matters Act (CAMA)[1]. Ministry of Finance Incorporated and Ministry of Petroleum Incorporated will be the shareholders of NNPC Ltd, upon incorporation, and they shall own NNPC Ltd in equal proportion.

2

The initial shareholders of NNPC Ltd may sell part of their shares to third parties, however, they must do so in equal proportion and are required to obtain FGN's approval and National Economic Council's (NEC) endorsement.

3

The President shall appoint the members of the board of NNPC Ltd if 100% ownership rests with the government. However, where a 3rd party owns a portion of NNPC Limited, the rules of CAMA will apply.

4

The President has the power to remove a member of the board of NNPC Ltd irrespective of the distribution of ownership. This power may be overbearing and contradicts best corporate governance practice where there is significant non-government ownership of NNPC Ltd

Transfer of assets and liabilities to NNPC Ltd

1

Within 18 months of the effective date, the MoP and MoF shall determine the assets, liabilities, and interests of NNPC to be transferred to NNPC Ltd and its subsidiaries and effect such transfers.

2

Assets, liabilities, and interest not transferred shall remain NNPC until they become extinguished or transferred to the FGN.

3

Within 6 months after such determination, the MoP, MoF, and Attorney General of the Federation (AGF) are required to develop the framework for the settlement of liabilities not transferred.

[1] CAMA is Nigeria's company law

After the completion of the transfer of assets, interests, liabilities, there is a chance that certain assets (and maybe petroleum operations) will be held directly by the FGN

4

If the government does not determine what assets, liabilities, and interests to be moved within the required 18 months, they will be deemed to have been moved

5

NNPC will cease to exist after its assets, interests and liabilities have either been extinguished or transferred to NNPC Ltd or transferred to FGN.

Additional commentary

After the completion of the transfer of assets, interests, liabilities, there is a chance that certain assets (and maybe petroleum operations) will be held directly by the FGN, which contradicts the overall principle of full commercialisation of Nigeria's petroleum operations.

Voluntary conversion to incorporated joint ventures

1

Existing unincorporated joint ventures, with NNPC participation, in respect of upstream petroleum operations, which are currently managed under the joint operating agreements (JOAs), may voluntarily convert into incorporated joint ventures companies (IJVCs).

2

The IJVC must always be the operator for upstream production activities. However, upon approval of the Commission, the IJVC may contract its operatorship functions to a service contractor.

3

Beyond upstream petroleum operations, IJVCs may invest in midstream and downstream operations, however, they must incorporate separate companies for those other investments.

4

The initial capitalization of the IJVC and the component transactions are exempted from any tax liabilities that would have arisen, provided that previously jointly held assets, interests, and liabilities, are transferred at net book value to the IJVC.

5

Where any shareholder of an IJVC intends to sell its shares, the other shareholders have the first right of refusal. Such sale of shares must be at fair market value and the MoP's approval must be obtained.

6

Each shareholder in an IJVC has the first right to purchase crude oil, condensates, natural gas, or petroleum products from the IJVC, at open market rates, in the proportion of its shareholding in the IJVC.

Commentary

An IJVC is independent of direct government control, hence it is not going to be exposed to the cumbersome government budgeting process and the JV funding issues currently experienced with UIJVs.

Where all NNPC Ltd's joint venture arrangements are incorporated as IJVCs, it will further position NNPC Limited as a true commercial entity and improves its chances of being a successful government enterprise, especially where the government's effective shareholding in individual IJVCs is less than 50%, as it is currently in the NLNG IJV (NNPC holds 49% while the international oil companies hold 51%).

As government currently holds more than 50% of most of its joint venture arrangements, it may be necessary for NNPC Ltd to sell a portion of its shares to other JV partners, such that it does not hold up to 50% to guarantee strong corporate governance.

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