



Inside NNPC Oil Sales: A Case for Reform in Nigeria

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Executive summary

Nigeria's national oil company, the Nigerian National Petroleum Corporation (NNPC), sells around one million barrels of oil a day, or almost half of the country's total production. NNPC oil was worth an estimated \$41 billion in 2013, and constitutes the government's largest revenue stream. Early in 2014, Nigeria's central bank governor Lamido Sanusi raised an alarm that \$20 billion in NNPC oil sale revenues had gone missing.

Our report picks up this story, and offers the first in-depth, independent analysis of how NNPC sells its oil. It identifies the most pressing problems—including several largely ignored by the prior government's response to Mr. Sanusi's allegations—and offers recommendations for their reform.

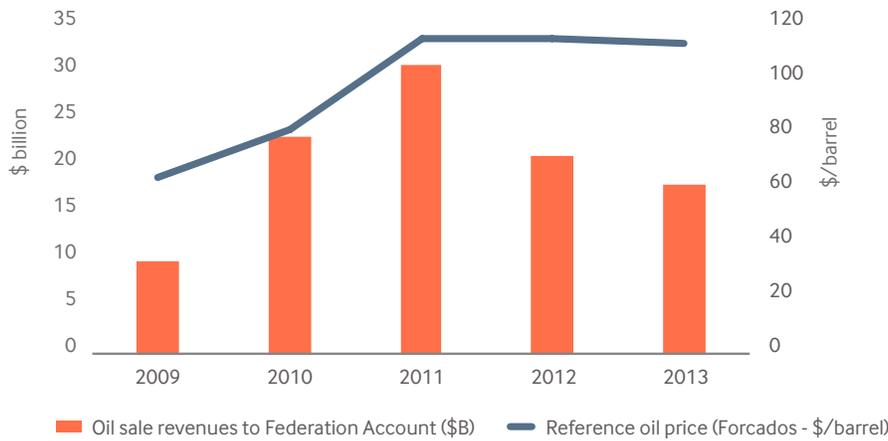
NNPC's approach to oil sales suffers from high corruption risks and fails to maximize returns for the nation. These shortcomings also characterize NNPC as a whole. Over 38 years, the corporation has neither developed its own commercial or operational capacities, nor facilitated the growth of the sector through external investment. Instead, it has spun a legacy of inefficiency and mismanagement. Its faults have been described by a number of scathing reports, many commissioned by government itself.¹ Despite NNPC's debilitating consumption of public revenues and performance failures, successive governments have done little to reform the company.

NNPC's approach to oil sales suffers from high corruption risks and fails to maximize returns for the nation.

We find that management of NNPC's oil sales has worsened in recent years—and particularly since 2010. The largest problems stem from the rising number of *ad hoc*, makeshift practices the corporation has introduced to work around its deeper structural problems. For instance, NNPC entered into poorly designed oil-for-product swap deals when it could no longer meet the country's fuel needs. Similarly, it began unilaterally spending billions of dollars in crude oil revenues each year, rather than transferring them to the treasury, because NNPC's actual budget process fails to cover operating expenses. Some of these makeshift practices began with credible goals. But over time, their operation became overly discretionary and complex, as political and patronage agendas surpassed the importance of maximizing returns.

These poor practices come with high costs. Average prices for the country's light sweet crude topped \$110 per barrel during the boom of 2011 to 2014. Yet during that same period, as shown below, treasury receipts from oil sales fell significantly. While volumes lost to oil theft explain some of the decline, NNPC's massive revenue withholdings and an increase in suboptimal sales arrangements are also to blame. Mismanagement of NNPC oil sales also raises commercial, reputational and legal risk for actors worldwide: the sales involve some of the world's largest commodity trading houses, are financed by top banks, and result in the delivery of crude to countries across the globe.

1 Government-commissioned reports include those by NEITI (covering 1999-2012), the Oil and Gas Implementation Committees (2003 and 2008), KPMG (2011), the Petroleum Revenue Special Task Force (2012), the Kalu Task Force (2012), the Lawan committee (2012), PwC (2015), and several parliamentary committees. Independent reports include those by Mark Thurber et al. (2012), Ugo Nwokeji (2007), Revenue Watch/NRGI (2012) and the Nigeria Natural Resource Charter (2012 and 2014). See main report for full references.



Oil prices versus Federation Account oil sale receipts, 2009-2013²

The most pressing problems with NNPC oil sales occur in five areas, described below. To arrive at this diagnosis, we reviewed published and unpublished official records, together with data from trade publications and secondary literature, and conducted dozens of interviews between 2010 and 2015. Our main report presents an overview of our findings. In annexes to the report, we further detail three topics: the domestic crude allocation, oil-for-product swap agreements, and government-to-government crude sales.

For each of the five issues, we also make recommendations for reform. In the current Nigerian context, reform is both urgent and feasible. The recent drop in oil prices has ushered in fiscal and monetary crises, particularly given the limited savings accumulated during the price boom. At the same time, demand for Nigerian crude has softened, due in part to the collapse of sales to the US. These revenue constraints come at a time when the oil sector itself sorely needs funds—as does Nigeria’s broader economy, which struggles to provide equitably for the country’s 170 million citizens.

In the current Nigerian context, reform is both urgent and feasible.

These economic imperatives coincide with political opportunities. President Muhammadu Buhari took office in May 2015, following his election victory over an incumbent government with a very poor record on oil sector governance. Expectations are high that the Buhari government will tackle the problem of NNPC performance. The president and other high-level figures in his APC party have made statements to that effect.

We recommend that the government make the most of this window of opportunity by pursuing two tracks of reform. The first involves urgent reforms to NNPC’s management of oil sales (to “stop the bleeding”), targeting the five issues outlined below. At the same time, however, the government should also pursue a course of deeper structural reforms to NNPC (to “cure the patient”). If it does not, a new round of costly, ad hoc coping mechanisms will emerge.

A few cross-cutting points underlie our recommendations:

- NNPC oil sales are Nigeria’s largest revenue stream and face severe problems. Fixing them should come first in the reform queue, before revisiting upstream contracts with international oil companies.
- Repairing oil sale governance does not require omnibus legislation like the Petroleum Industry Bill (PIB). Rather, a bold and targeted agenda with a one-to-two-year timeline better suits Nigeria’s political timetables.

2 Federal Budget Office 4th Quarter Budget Implementation Reports, 2009-2013; Platts data.

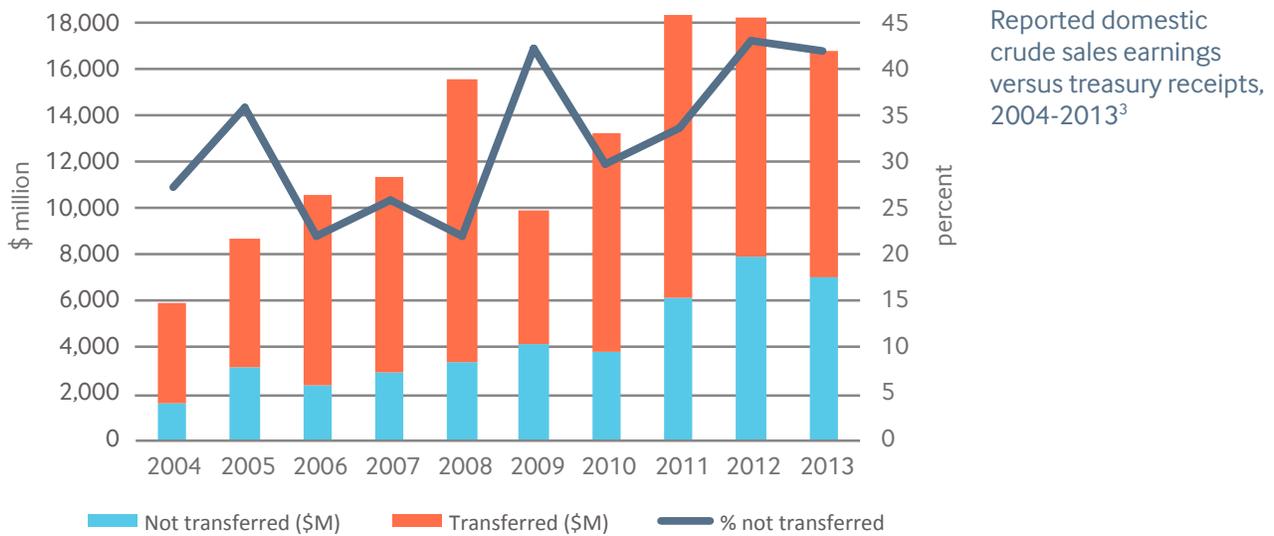
- When overhauling oil sales, the government should prioritize simplicity throughout. Current governance problems thrive on byzantine arrangements which only a handful of people understand.
- The bad practices that undermine NNPC oil sale performance all have political interference at their root. Only sustained leadership from the very top will shift incentives towards performance and away from patronage.

TARGETING URGENT PROBLEMS WITH NNPC OIL SALES

<div style="display: inline-block; background-color: #e67e22; border-radius: 50%; padding: 10px; margin-right: 10px;"> issue 1 </div> The Domestic Crude Allocation (DCA)	
Problems	<ul style="list-style-type: none"> • The DCA has become the main nexus of waste and revenue loss from NNPC oil sales. In 2013, the Federation Account (Nigeria’s treasury) received only 58 percent of this oil’s \$16.8 billion value. • The DCA was designed to feed Nigeria’s refineries, but in practice NNPC exports three quarters of the so-called domestic crude. • NNPC’s discretionary spending from domestic crude sale revenues has skyrocketed, exceeding \$6 billion a year for the 2011 to 2013 period. • NNPC’s explanations for how it spends the revenues it retains are incomplete and contradictory, and the spending (such as on the fuel subsidy and downstream operations) delivers poor value for money.
Recommendation	The government should eliminate the DCA, which creates more problems than it solves.

The domestic crude allocation (DCA) has become the main nexus of waste and revenue loss from NNPC oil sales. The government allocates around 445,000 barrels per day to NNPC in so-called “domestic crude.” NNPC sells this oil to the Pipelines and Product Marketing Company (PPMC), one of its subsidiaries. PPMC is supposed to send the oil to Nigeria’s four state-owned refineries, sell the resulting petroleum products, and pay NNPC for the crude it received, and then NNPC is supposed to pay the government. In practice, the refineries only process around 100,000 barrels per day. NNPC ultimately re-routes most DCA oil into export sales or oil-for-product swaps, and payments enter separate NNPC accounts, which NNPC officials then draw upon freely. Annex A contains a full discussion of the DCA.

The DCA facilitates some of NNPC’s worst habits, and no longer serves its intended purpose. NNPC’s discretionary spending from domestic crude returns has reached runaway, unsustainable levels, averaging \$6 billion a year between 2010 and 2013. Especially now that Nigeria faces major budgetary and savings shortfalls, unchecked off-budget spending on this scale threatens the nation’s economic health. In 2004, NNPC retained around \$1.6 billion, or 27 percent of the DCA’s full assessed value. By 2012, the amount had jumped to \$7.9 billion—or 42 percent of the value of the domestic oil for that year.



The DCA revenues spent by NNPC deliver poor value for money. A large portion of NNPC’s withholdings is spent on fuel subsidy payments, which are vulnerable to misappropriation and excessive spending. KPMG for example found that in three years, NNPC paid itself roughly \$6.5 billion to fund the subsidy on 15.6 billion liters of products that “apparently were not available to the Nigerian market.”⁴ NNPC has also spent hundreds of millions of dollars in DCA revenues on pipeline protection, but levels of theft from some crude oil pipelines have risen—in some cases by over 500 percent in a year. Since 2011, NNPC has spent as much as \$7.52 per barrel to transport oil to the refineries by ship under an opaque, multi-vessel arrangement (as compared with \$0.03 per barrel in pipeline fees), yet refinery outputs during the period did not improve.

Moreover, NNPC administers the DCA with few rules and weak oversight, causing chronic confusion. Debates abound on whether NNPC can legally retain DCA revenues, as seen in the controversy about whether it had permission to withhold several billion dollars annually for a kerosene subsidy that a prior government had slated for elimination.⁵ There is no contract between NNPC and PPMC for DCA sales, despite their huge value.⁶ In terms of reporting, NNPC’s explanations about where the money goes are incomplete and contradictory: past audits showed the corporation claiming hundreds of millions of dollars in duplicated or undocumented expenses—\$2.07 billion in nineteen months, PwC found.⁷ We saw no evidence that NNPC includes the amounts actually paid by buyers of domestic crude in its reports to other government agencies. Controversies and competing claims, such those kicked off by Sanusi’s accusations that the treasury was “missing \$20 billion,” thrive in such a context.

NNPC’s explanations about where the money goes are incomplete and contradictory.

3 2004-2012 data is from NEITI financial audit reports. 2013 data is from the 2013 NNPC Annual Statistical Bulletin; NNPC Report: Reconciled Receipts of Domestic Crude Cost, January 2013-date; and, NNPC Report: Computation of Revenue from Domestic Crude Oil Receipts, January 2013 to Date.
 4 KPMG-S.S. Afemikhe, Final Report on the Process and Forensic Review of the Nigerian National Petroleum Corporation (Project Anchor), Volume One – Executive Summary & Main Report (“the KPMG project anchor report”), 2011, sec.6.3.4.
 5 PwC, Investigative Forensic Audit into the Allegations of Unremitted Funds into the Federation Accounts by the NNPC (“the PwC report”), February 2015, p.17.
 6 NEITI, 2012 Oil and Gas Audit Report. p.202.
 7 PwC report p.13.

issue
2

Revenue retention by NNPC and its subsidiaries

<p>Problems</p>	<ul style="list-style-type: none"> • NNPC has invented a makeshift system for financing its operations, and is discretionarily retaining ever-growing sums. • NNPC’s five oil trading subsidiaries have acquired no independent trading capacity, but act as passive middlemen on large sales volumes (144,010 barrels per day in 2012, worth \$5.9 billion). NNPC does not disclose what happens to the commissions earned by the subsidiaries on these sales. • Available records indicate NNPC retained revenues from the sale of 110 million barrels of oil over ten years from one block controlled by its subsidiary NPDC, worth an estimated \$12.3 billion.
<p>Recommendation</p>	<p>The government should develop an explicit revenue collection framework for NNPC that facilitates more predictable financing and reigns in discretionary spending.</p>

Most countries adopt an explicit set of financing rules for their national oil companies. Nigeria, by contrast, allows NNPC to cobble together funds from different sources, usually outside of formal budget processes. Along with retaining billions each year in DCA oil sale revenues, NNPC withdraws funding intended for joint venture cash calls to cover unrelated expenses—off-budget spending that totaled \$4.2 billion from 2009 to 2012.⁸ Some of NNPC’s subsidiaries also retain their revenues, or transfer them to NNPC’s central accounts. NNPC has also sourced third-party financing to cover further expenses at unknown costs to the nation. This makeshift system at once impoverishes NNPC and gives it far too much discretion to retain ever-growing sums.

In the area of oil sales, the retention of revenues by two sets of NNPC subsidiaries raises particular concern. The first are NNPC’s five oil trading subsidiaries, headquartered mostly offshore. Originally set up to market crude and products for NNPC, after decades they function like passive middlemen, flipping the crude allocated by the corporation to experienced trading houses like Vitol or Glencore. NNPC routed 144,010 barrels per day through two offshore subsidiaries, Duke and Calson, in 2012 – oil worth \$5.9 billion. Neither NNPC nor the subsidiaries themselves disclose how much they earn or how they distribute their earnings.

Company (country of incorporation)	NNPC ownership stake	JV partner
Duke Oil Company Inc. (Panama)	100 percent	none
Duke Oil Services Ltd. (UK)	100 percent	none
Calson Ltd. (Bermuda)	51 percent	Vitol
Hyson Ltd. (Nigeria)	60 percent	Vitol
Napoil Company Ltd. (Bermuda)	51 percent	Trafigura

NNPC trading companies

The other subsidiary which warrants scrutiny is the Nigerian Petroleum Development Company (NPDC), NNPC’s main upstream division. Available records suggest that when the corporation sells oil from blocks owned by NPDC—which produced a reported 80,243 barrels per day in 2013—it does not forward the resulting proceeds

8 NEITI Oil and Gas Financial Audit Reports, 2009-2011 and 2012.

to the treasury. The revenues it holds on to are substantial: in its review of the Sanusi accusations, PwC sorted through three sets of conflicting figures, and estimated total earnings from NPDC oil sales at \$6.82 billion over a 19-month period in 2012 and 2013.⁹ NPDC does not need such large withholdings: the majority of its blocks are developed under contracts—including one service contract and several Strategic Alliance Agreements—that require private partners to cover its share of operating costs. NNPC has not explained how the funds it retains are spent.

A case in point is offshore OML 119, a NPDC block governed by a service contract. NNPC sold around 33,000 barrels per day of OML 119’s Okono grade crude in 2014. Our research found no evidence that NNPC forwarded to the treasury any revenues from sales of Okono crude between 2005 and 2014, volumes which totaled over 100 million barrels with an estimated value of \$12.3 billion. In other words, the corporation has provided no public accounting of how it used a decade’s worth of revenues from an entire stream of the country’s oil production.

The corporation has provided no public accounting of how it used revenues from an entire stream of oil production.

The government should develop a new, legally mandated mechanism for funding NNPC operations. A successful financing model would be established in law and resolve the conflict between the country’s constitution and the NNPC Act concerning revenue withholdings; create a binding budgetary process for NNPC with adequate checks and balances; and place strict limits on extra-budgetary spending. Clear rules on revenue retention by subsidiaries are also needed.

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<p>Problems</p>	<ul style="list-style-type: none"> NNPC channeled oil worth \$35 billion to swap deals between 2010 and 2014. In 2015, nearly 20 percent of the oil sold by NNPC has been traded for petroleum products via poorly structured deals with two companies. Recent offshore processing agreements (OPAs) contained unbalanced terms that did not efficiently serve Nigeria’s needs. We estimate that losses from three provisions in a single contract could have reached \$381 million in one year (or \$16.09 per barrel of oil). Swap imports are vulnerable to downstream rackets around Nigerian fuel transportation, distribution and sales.
<p>Recommendation</p>	<p>The government should direct NNPC to wind down all OPAs and should not sign any more such deals. Future swaps should be competitively awarded refined product exchange agreements (RPEAs) with stronger terms.</p>

Currently, NNPC routes around 210,000 barrels per day, or one-tenth of the country’s entire production, through deals with unacceptably high governance risks. Seven swap deals have been signed since 2010; we discuss these deals in detail in annex B.

RPEA and OPA holders,
2010-present

No.	Party	Oil allocation (barrels per day)	Duration
Refined Product Exchange Agreements (RPEAs)			
1.	Trafigura Beheer BV	60,000	2010-2014
2.	Duke Oil (Panama) Ltd., which entered into subcontracts with several companies who managed 30,000 barrels per day apiece:		2011-2014
2.a	→ Taleveras Petroleum Trading BV	→ 30,000	2011-2014
2.b	→ Aiteo Energy Resources Ltd.	→ 30,000	2011-2014
2.c	→ Ontario Trading SA	→ 30,000	2011-2014
3.	Duke Oil (Panama) Ltd., which subcontracted to:	30,000	2015-2016
3.a	→ Aiteo Energy Resources Ltd.	→ 30,000	2015-?
Offshore Processing Agreements (OPAs)			
1.	Nigermed Ltd., a fuel marketing joint venture between NNPC and British Petroleum (BP)	60,000	2010
2.	Société Ivoirienne de Raffinage (SIR), which entered into a subcontract to manage the full amount with:	60,000	2010-2014
2.a	→ Sahara Energy Resources Ltd.	→ 60,000	2010-2014
3.	Sahara Energy Resources Ltd.	90,000	2015-2016
4.	Aiteo Energy Resources Ltd.	90,000	2015-2016

Currently, NNPC operates two 90,000-barrel-per-day OPAs. We find that this type of deal is less suitable for Nigeria than its alternative, the RPEA. An OPA’s higher complexity makes it more opaque—and more open to abuse. Whether Nigeria receives good value depends on many technical factors that are difficult to negotiate and monitor. OPAs supply a wide slate of products when NNPC only requires two, gasoline and kerosene. Also, the structure of the OPAs, which envisions the oil being refined by a particular refinery, does not align with their actual operations. Moreover, our analysis of two OPA contracts, the 2010 deal with SIR/Sahara and the 2015 deal with Aiteo, reveals a number of underspecified, unbalanced provisions. We estimate Nigeria may have lost up to \$381 million in a single year of operations (or \$16.09 per barrel), if just three of the inappropriate provisions were fully exploited. RPEAs better suit Nigeria’s needs: traders that hold RPEAs deliver specified products that equal the value of the crude they receive, minus agreed fees and expenses.

Nigeria will likely continue using oil-for-product swap agreements until its debts to fuel importers are brought under control or it solves its refining woes. During this period, NNPC should improve the structure and execution of the swaps. Specifically, NNPC should close out the OPAs with Sahara and Aiteo as soon as possible, and should not sign any more OPAs. RPEAs should be used for future swap deals. However, to obtain fair returns for Nigerian citizens, NNPC should award the RPEAs through competitive tenders to capable companies; and ensure that the RPEAs contain certain updated terms—particularly on fuel pricing—and that they contain stronger reporting and oversight requirements. Annex B details these recommendations.

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Critically, traders holding NNPC-PPMC swap contracts deliver fuel into the existing supply chain for Nigerian fuel imports. As the 2012 fuel subsidy scandal revealed, the complexity of the supply chain serves a number of entrenched, lucrative rackets around shipping, distribution and sales of fuel. These include smuggling, selling locally refined products back to NNPC at import prices, over-charging for deliveries, and outright theft.¹⁰ The 2012 fuel subsidy investigations focused mainly on the mismanagement of standard import contracts, but we find that swap imports carry many similar risks. Unless the worst rackets around fuel imports are eradicated, the swaps will hemorrhage considerable amounts of fuel and money no matter how they are structured.

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The abundance of middlemen	
Problems	<ul style="list-style-type: none"> • Nigeria is the only major, stable world oil producer that sells crude mostly to traders rather than end-users. • NNPC enters into term contracts with unqualified intermediaries that capture margins for themselves and create reputational risks for legitimate market players while adding little or no value to deals. • NNPC also sells to governments that do not refine the crude they buy. These deals have featured a glut of unnecessary middlemen, and prompted corruption scandals in five buyer countries.
Recommendation	<p>NNPC should stop selling oil to unqualified companies, whether Nigerian or foreign, and improve its due diligence standards.</p>

The marketplace for NNPC crude is uncommonly crowded with intermediaries. By our count, Nigeria is the world’s only major oil producer (i.e., with average outputs of well over 1 million barrels per day) that sells almost all of its crude to middlemen, rather than end-users (with the exception of highly unstable countries like Libya). Over 90 percent of the barrels NNPC allocated in 2014 went to trading companies rather than end-users.

The names on NNPC’s lists of approved buyers, numbering 43 in 2014, include a small group of large, experienced Nigerian and foreign commodity traders and many low-profile, inexperienced “briefcase companies.” This latter group poses especially high governance risks. For instance, some reportedly help buyers of the oil to avoid taxes and channel payments to politically exposed persons (PEPs). Involving middlemen who serve no commercial function creates a marketplace with greater commercial, reputational and legal risks for its legitimate participants, which include some of the world’s leading trading houses, banks and refiners. Past NNPC oil sales to the governments of Zambia and South Africa are good examples: in both, NNPC sold to intermediaries that lacked basic capacities, which led to corruption scandals in those countries. (See annex C for a full discussion of these government-to-government deals.)

Involving middlemen who serve no commercial function creates a marketplace with greater risks for its legitimate participants.

10 See e.g., Virginie Morillon, and Servais Afouda, “Le trafic illicite des produits pétroliers entre le Bénin et Nigeria,” *Economie Régionale* (LARES), 2005; Nigerian House of Representatives, Report of the Ad-Hoc Committee To Verify and Determine the Actual Subsidy Requirements and Monitor the Implementation of the Subsidy Regime in Nigeria (Farouk Lawan, chair) (“the Lawan Report”), April 2012, p.112.

Going forward, NNPC should stop selling oil to companies, whether Nigerian or foreign, that never sell their allocations to refiners; that routinely sell to big trading companies that are already NNPC term customers; or that have ties to PEPs. To further protect against favoritism, patronage and inappropriate payments, NNPC should grant its next round of term contracts through openly competitive and rule-bound procedures that include a strict pre-qualification process, robust due diligence checks, and restrictions on the use of offshore vehicles by buyers. The corporation should also publish written rules for parceling out cargoes each month to buyers and stop allocating export contracts for more crude than it has to export. This will help end the monthly jockeying for allocations that occurs now, which is highly prone to corruption. Over the medium term, NNPC should rework its buyer selection process to secure more reliable global demand for Nigerian crude, and to sell more oil directly to refineries.

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Problems	<ul style="list-style-type: none"> • NNPC reporting to other government agencies and the public on oil sales is patchy and regularly contains contradictions. • The corporation’s own internal recordkeeping systems and processes are disorganized and secretive. • The corporation lacks basic checks and balances—for example, no published annual reports, weak audit functions and a board chaired by the petroleum minister.
Recommendation	The presidency should lead a program of transparency and accountability reforms for NNPC, and empower oversight actors to scrutinize the corporation’s decisions.

NNPC’s management has a history of resisting outside scrutiny. The corporation discloses very little about its finances and operations, even though more than half of public revenues flow through it. Officials from other government bodies say they cannot independently verify or challenge the oil sale figures provided by NNPC.¹¹ Past reviews described NNPC’s internal oil sale data management practices as disorganized, secretive and inaccurate. For example, one government task force found two separate sets of oil sale books that diverged at times by more than \$100 million per year.¹² Corporation officials have faced few consequences for mismanagement—at most, they tend to be retired or transferred to other posts.

Reforms in several areas can help reverse this trend. To reduce perceptions of impunity, the government should commission independent performance audits of areas of concern, including: the DCA; oil-for-product swaps; NPDC oil sales and related operations; NNPC’s oil trading subsidiaries; the refinery crude oil transport arrangement; and the JV cash call account.

11 Author interviews, officials from CBN, Finance Ministry, Auditor-General’s Office, FAAC and NEITI, 2010-14. NNRC Benchmarking Report Sec.2.2.10.
 12 Federal Ministry of Petroleum Resources, Report of the Petroleum Revenue Special Task Force (Nuhu Ribadu, chair), p.89.

Transparency and accountability must also advance. The government should require NNPC to regularly disclose detailed and prompt cargo-by-cargo data on all its crude oil liftings, and issue a 2015 annual report that includes its audited financial statements, operational data, the financial positions and earnings of its subsidiaries, and disclosures on quasi-fiscal spending. Independent audits should occur regularly, and NNPC should publish the resulting reports. Moreover, we recommend that NNPC establish clear work programs and performance benchmarks, so that oversight actors like the National Assembly, auditor-general, and others can then assess whether those benchmarks are regularly met. The NNPC board should meet regularly, include independent members, and have a chair other than the petroleum minister.

The government should require NNPC to issue a 2015 annual report that includes its audited financial statements.

SOLVING NNPC'S UNDERLYING PROBLEMS

As we argued at the outset, maximizing full returns from NNPC oil sales will depend on pursuing two trajectories of reform – the measures described above, and a broader agenda of NNPC restructuring. Without the latter, the Buhari government will end up relying on a range of stop-gap measures, and NNPC's performance will plateau at best.

The high oil prices of the early 2000s allowed NNPC to “muddle through,” as extra cash flows masked the inadequacies of its various short-term workarounds. Now that this luxury has ended, the Nigerian government should revise the NNPC joint venture cash call system; eliminate the fuel subsidy; remove NNPC as a commercial player from the downstream sector; tackle crude oil theft; and develop and implement a road map for restructuring and commercializing NNPC. The final section of the main report offers deeper analysis and recommendations on each of these points.

Nigeria can no longer afford to leave NNPC's dysfunctional and costly oil sales system as it is. The status quo, characterized by convoluted, under-policed deals with weak commercial justifications, has cost Nigeria revenues that it needs for its development priorities. The reforms recommended in this report would significantly increase the returns to the Nigerian government from the sale of its crude oil, even at today's lower prices. More broadly, improved oil sale functions would help create a solid foundation for remaking NNPC into a company that serves Nigeria's citizens, rather than the interests of a privileged few.

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Introduction

Most companies that lose billions of dollars a year have short lifespans. Not so for Nigeria's national oil company, the Nigerian National Petroleum Corporation (NNPC), now in its 38th year. Beginning decades ago, a steady stream of reports and reviews have documented the company's dismal legacy of lost revenues, inefficiency and corruption in eye-watering detail. Its problems are well known and widely agreed upon, yet meaningful solutions have not taken root. Despite the lost earnings and the glaring performance failures—and persistent poverty in many segments of Nigerian society—successive heads of state have avoided fundamental reform. Multiple versions of the Petroleum Industry Bill, aimed at reforming the company, have died in parliament. The persistent absence of political will illustrates just how deeply NNPC is embedded in the power structures of Nigeria, and how difficult a job true reformers face.

The biggest abuses of power—and public revenue losses—come from the many *ad hoc*, makeshift practices the corporation has introduced to work around its deeper structural problems. When crippling debts and corruption scandals left NNPC unable to supply enough fuel for the nation, it entered into overly complex, opaque and costly oil-for-product swap deals. When NNPC's main upstream subsidiary could not cover its share of operating costs, it signed ill-suited strategic alliance agreements (SAAs) with handpicked, opaque, private companies—but this did not fully solve the financing problems. When NNPC's formal budget allocation fell short of operating expenses, the company discretionarily withheld billions of dollars from oil sales, spending the money in a secretive, off-budget manner. Over and over, management has addressed the corporation's chronic ailments with quick fixes characterized by secrecy, undue complexity, and an absence of oversight.

This report focuses on one of NNPC's central functions: the sale of Nigeria's crude oil. The oil that NNPC handles has a value equal to more than half of the country's total government revenues. Management of these sales has worsened in recent years, mainly through an increase in makeshift transactions and discretionary revenue withholdings. Oil sale governance is integral to many broader aspects of NNPC governance, and as such offers a useful entry point for thinking about what bigger reforms and restructurings are needed. In a time of low oil prices and softening global demand for Nigerian crude, the country can no longer afford sale processes that deliver poor value.

In the sections that follow, we introduce our methodology and research process, and explain the basics of how NNPC's oil sales work. Next, we explain why the health of Nigeria's economy, the integrity of its government, and the legal, financial and reputational risks to all players in the Nigerian oil market depend on reforming NNPC oil sales in an urgent manner. We then outline a two-track reform agenda that includes five areas of urgent fixes and also bigger structural changes. In the annexes to this report, we provide greater detail on three important topics: the domestic crude allocation, the oil-for-product swap agreements, and government-to-government crude sales.

Governance of NNPC is not an intractable problem. The current environment of low oil prices, fiscal hardship and political transition offers Nigeria the best chance for reform in years. We urge the Nigerian leadership to go forward with its commitment to tackle NNPC once and for all, starting with oil sales.

The current environment of low oil prices, fiscal hardship and political transition offers Nigeria the best chance for reform in years.

Objectives and methodology

NRGI offers the following analysis in order to:

- Make forward-looking recommendations to the Nigerian government for increasing returns to the nation from NNPC oil sales.
- Increase transparency and public knowledge of NNPC oil sales.
- Provide contextual information and possible direction for future audits of past activities.
- Persuade commercial players (e.g., traders, refiners, banks, shipping companies) to take more seriously the governance risks of NNPC oil sales, and to strengthen their practices for understanding and mitigating risks.

Findings are based primarily on reviews of published and unpublished official records, data from trade publications and other market sources, secondary literature, and over forty interviews conducted between 2010 and 2015 with representatives of the relevant government agencies, multiple NNPC divisions, foreign and Nigerian oil and oil trading companies, civil society, journalists, independent experts, and international organizations.

Most of the figures in this report come from NNPC documents, or from the reports of government-commissioned probes of NNPC's operations which themselves rely heavily on data collected from the corporation. While we took steps to authenticate the documents, we were often unable to independently verify or reconcile the numbers they contained. Therefore, we cannot vouch for the full accuracy of the official figures reproduced in this report, particularly in view of the many problems with NNPC's record-keeping and reporting for oil sales described later (for example, see pages 60-61). Several of the key documents informing this report are available on the NRGI website at www.resourcegovernance.org/publications/inside-NNPC-oil-sales.

Given these limitations, no actor outside of NNPC could determine precisely how much the company's crude oil sales system has earned or lost Nigeria. The estimates of government losses put forward at various points are not substitutes for a rigorous audit conducted with NNPC's cooperation. We in some cases rely on hypotheticals and assumptions, and these are stated explicitly where they occur. Nonetheless, we feel that the data available is of sufficient quality to confidently identify the main trends and priorities for reform.

No actor outside of NNPC could determine precisely how much the company's crude oil sales system has earned or lost Nigeria.

As part of our research process, we wrote formal letters to several of the participants in NNPC oil sales, informing them of the project, asking a number of detailed questions on the issues discussed in this report, and indicating our openness to dialogue and to learning their perspectives. The letters were sent by email, fax and courier. Specifically, we sent letters in April 2015 to NNPC and two of its subsidiaries, the Pipelines and Product Marketing Company (PPMC) and Duke Oil Ltd. We also sent letters to trading companies that held swap contracts, including Aiteo Energy Resources Ltd., Ontario Trading SA, Sahara Energy Resources Ltd., Société Ivoirienne de Raffinage (SIR), Taleveras Petroleum Trading BV, and Trafigura Beheer BV, as well as to a director and shareholder of PPP Fluid Mechanics, one of the companies involved in the refinery oil marine transport arrangements.

NNPC, PPMC, Duke Oil Ltd., Ontario Trading SA, SIR and PPP Fluid Mechanics did not respond to our communications. NNPC has answered similar questions in the past, to audiences including the media and NEITI. We drew on those explanations when possible so as to represent their views. Aiteo replied and asked that we enter into a non-disclosure agreement before they could share information, given confidentiality concerns. We declined, since the questions pertained to a report intended for public release, and asked that they nonetheless provide some information. They did not respond further. Sahara wrote to us and indicated that their response was contained in press releases they issued in May and June 2015 about the swap deals.¹³ We reviewed these materials and cite them in this report. Trafigura and Taleveras provided written responses to some of the questions; others they elected not to answer citing confidentiality constraints. Representatives of these two companies also made themselves available for several phone conversations about the questions that we asked. Their views informed the research, and are cited in the text.

13 The Sahara press releases are available here: <http://www.sahara-group.com/cg/opa-updated.pdf>; and http://www.sahara-group.com/cg/Saharas_Update_on_OPA.pdf.

The basics of NNPC oil sales

This section summarizes the nuts and bolts of NNPC oil sales. Details of specific transactions are explored in the annexes to this report, and in the next sections. Because NNPC uses a relatively complicated system for selling crude and handling sales proceeds, it is important to understand the basics before delving into the detail. Figure 1 contains an overview of the various transactions.

SOURCES OF NNPC'S OIL ENTITLEMENT

NNPC sells oil from three main sources:

- 1 *Joint venture equity crude.* This is the Nigerian government's share of oil produced under various joint ventures (JVs) with international oil companies (IOCs). Each of the JVs owns and operates one or more oil licenses allocated by the government, most of them located onshore or in shallow water around Nigeria's southern coastline. NNPC holds either a 55 or 60 percent equity interest in each JV, which usually entitles it to a production share equal to its ownership stake. However, this amount can decrease through the oil-backed financing arrangements that NNPC has entered into with some of its JV company partners. The JVs account for around two-thirds of the oil Nigeria pumps each day. In 2013, NNPC sold 639,983 barrels per day in JV equity oil, accounting for 64 percent of the corporation's total sales.¹⁴
- 2 *Oil from production sharing contracts.* Under a typical Nigerian production sharing contract (PSC), the federal government awards a license to one or more private companies, which take responsibility for operating the block. The companies bear the risk and costs associated with exploration and production, and retain a share of the resulting oil to cover these costs. PSC operators commonly pay their tax¹⁵ and royalty¹⁶ obligations to Nigeria in oil rather than in cash. NNPC markets this oil on behalf of the government.¹⁷ After these barrels of "tax oil" and "royalty oil" are subtracted out of the total volume produced under the PSC, the remaining "profit oil" is divided between the operating companies and government in proportions set out in the PSC. NNPC receives Nigeria's share of profit oil from the roughly half-dozen PSCs currently operating in the country and markets it on the government's behalf. PSCs contribute most of the remaining third of average daily production in Nigeria. In 2013, NNPC sales of PSC oil – both profit oil and tax and royalty in-kind volumes – totaled 285,544 barrels per day.¹⁸

NNPC sold 639,983 barrels per day in JV equity oil, accounting for 64 percent of the corporation's total sales.

14 NNPC 2013 Annual Statistical Bulletin.

15 The main taxes that upstream companies pay on their operations in Nigeria are called "petroleum profit taxes" (PPT). Provisions of the 1990 Petroleum Profit Tax Act, together with provisions in some contracts and memoranda of understanding, form the basis of their obligations.

16 A royalty is a payment to a government by a company involved in oil extraction for the rights to extract and sell oil from its license area. Nigeria's 1969 Petroleum Act sets base rates, which later laws and contracts have altered in some cases.

17 For more details, see Nigeria Extractive Industries Transparency Initiative (NEITI), 2009-11 Oil and Physical and Process Audit Report, Appendix B.

18 NNPC 2013 Annual Statistical Bulletin.

- 3 *Oil from blocks owned by NPDC.* NNPC has assigned its equity in around a dozen onshore and offshore blocks to the Nigerian Petroleum Development Company (NPDC), its main upstream subsidiary.¹⁹ These assets are operated variously under JVs, PSCs and one service contract. Some important problems and questions around NPDC are discussed on pages 38 to 41 of this report. NNPC sold 80,243 barrels per day of crude from NPDC blocks in 2013.²⁰

Between 2004 and 2014, these three sources of crude gave NNPC around one million barrels per day—or between 41 and 53 percent of total Nigerian production—to sell.²¹

MAIN MECHANICS AND TYPES OF SALES

NNPC's Crude Oil Marketing Division (COMD) sells most of Nigeria's share of production for export. A smaller portion (in 2013, around 35 percent of NNPC sales) goes to feed the country's four refineries, or is allocated to oil-for-product swap deals. We discuss these more specialized transactions further on pages 42-46 below, and in annex B.

For the export sales, COMD structures the transactions almost exclusively through longer-term sales agreements, called "term contracts." A typical COMD term contract lasts one year, and grants its holder the ability to purchase and lift²² a set allocation of the government's equity share of Nigerian oil production—usually between 10,000 and 60,000 barrels per day.²³ COMD tends to award term contract awards in one batch per year, though sometimes more. COMD has often rolled over the prior year's contracts, extending them beyond their initial expiration dates. It has also executed one-off transactions for individual cargoes of crude (called "spot sales").²⁴ COMD puts out a request for applications several months before it announces awards, usually in local newspapers. Although the advertisements list some award criteria—for example, minimum annual turnover and "local content" requirements²⁵—COMD does not consistently follow these in its bid evaluations, and overall, the term contract award process is more a discretionary selection than an open, competitive tender. (See pages 46-59.)

Most recently, the corporation reportedly signed at least 43 term contracts in 2014 (for a list, see figure 11), and has rolled these contracts over to 2015. Most contract holders are trading companies, together with a few foreign governments. Direct sales to foreign refineries are rare, setting Nigeria apart from most major oil-producing countries.²⁶

Between 2004 and 2014, three sources of crude gave NNPC around one million barrels per day—or between 41 and 53 percent of total Nigerian production—to sell.

19 For a list of NPDC-owned blocks, see <http://npdc.nnpcgroup.com/Operations/Assets.aspx>.

20 NNPC 2013 Annual Statistical Bulletin.

21 NNPC Annual Statistical Bulletins.

22 "Lifting" refers to the process of loading oil onto a ship at an export terminal.

23 NNPC introduced the term contract system in 1984-85. Prior to that, it had relied on long-term offtake agreements with IOCs and other companies operating in Nigeria.

24 NNPC has said publicly that it does not sell any oil through spot sales. See e.g., <http://www.nnpcgroup.com/nnpcbusiness/businessinformation/investmentopportunities/crudeoilmarketing.aspx>. However, our review of internal NNPC oil sale records found individual cargoes sold to companies not on the corporation's annual term contract lists.

25 For an example, see <http://tenders.nigeriang.com/federal-government-tenders-in-nigeria/invitation-for-crude-oil-term-contract-application-at-nigerian-national-petroleum-corporation/12973/>.

26 The vast majority of large exporters sell to refineries, not traders. For explanations of how other NOCs sell their oil, see the series of briefs on *Selling the Citizens' Oil*, 2012, Natural Resource Governance Institute. <http://www.resourcegovernance.org/publications/selling-citizens-oil>.

NNPC sets sale prices for each of Nigeria's 26 grades of crude oil on a monthly basis.²⁷ Specifically, most of the oil NNPC sells for export is valued using a widely-used formula pricing system called "official selling prices" (OSPs). Each OSP has three components:

- 1 *Benchmark*. This is an average of five consecutive price quotations for Brent crude, as published by the trade periodical *Platts*.
- 2 *Differential*. This is the premium or discount to Brent, expressed in dollars per barrel, that is supposed to reflect the market value of the particular crude grade vis-à-vis Brent. NNPC publishes a new differential once per month for each of the country's 26 crude grades.
- 3 *Pricing Option*. This feature allows a buyer to pay a small premium—usually \$0.05 to \$0.10 per barrel—which entitles the buyer to choose before lifting which five-day Brent quotations NNPC will use to price the cargo.²⁸

Each month, NNPC divides its share of the available oil into cargoes and allocates these to the companies that hold the term contracts, who then sell them on to other buyers. The typical cargo size is roughly 950,000 barrels.²⁹ Recently, COMD has had between 20 and 30 cargoes of oil to sell per month. All cargoes are sold "free on board" (FOB).³⁰

NNPC divides its oil sales into two main categories:

- *Export sales*. COMD sells well over half of the nation's oil to term customers for export. Most of the proceeds from these sales go into the treasury after first being collected in a dollar-denominated Crude Oil Account with JPMorgan in New York—or else they pool first in separate accounts managed by the Federal Inland Revenue Service (FIRS) and the Department of Petroleum Resources (DPR), in the case of tax oil and royalty oil sales. A portion of JV equity sale revenues enter different accounts for the purpose of paying NNPC's cash call liabilities, which are its share of the operating and capital expenses associated with the JV activities. The remaining proceeds are forwarded monthly to the Federation Account, the central account into which most public oil revenues are deposited and then shared monthly between the federal, state and local tiers of government according to a formula chosen by parliament.
- *The domestic crude allocation ("DCA")*: NNPC sells roughly 445,000 barrels per day on an intercompany basis to the PPMC, its main downstream subsidiary. The country's four NNPC-owned refineries are supposed to process 445,000 barrels per day if they run at full capacity. PPMC is meant to pay NNPC for this crude, and then NNPC is supposed to send the funds to the Federation Account.

NNPC sets sale prices for each of Nigeria's 26 grades of crude oil on a monthly basis.

27 Nigeria has several hundred active oil wells. For purposes of export, these are combined into "grades" of crude oil. NNPC does not have equity interests in all of these, as some are developed on a "sole risk" basis. Each grade has different geological properties and produces different types, qualities and volumes of products when refined. Different users and markets have higher demand for some products than others. Grades are often named after the terminals from which they are exported.

28 For more on how the pricing options work, see NEITI, 2009-11 Physical and Process Audit, p.2.

29 The IOCs operating in Nigeria ship and sell roughly 30 more cargoes of their own, and for local companies, through separate processes.

30 In maritime law, use of the term "FOB" in a buyer-seller transaction means that the seller pays for transportation of the goods involved to the port of shipment, plus loading costs. From that point, the buyer assumes ownership of the goods and pays the costs of marine freight transport, insurance, unloading, and transportation to the final destination.

This simple two-part system has broken down, however, especially during the 2010-2015 period. As NNPC's financial and operational problems deepened, it introduced more types of makeshift oil sale transactions, many grouped under the domestic crude system. Because the chronically underperforming refineries only process around 20 percent of the DCA, DCA crude goes in at least three separate directions:

- 1 *Supply to refineries.* These are the barrels that PPMC actually refines locally. This supply totaled 104,909 barrels per day in 2013.
- 2 *Oil-for-refined product swap deals.* Around 200,000 barrels per day are allocated to these complex transactions between PPMC and traders. They are discussed in annex B of this report.
- 3 *Export sales of non-refined "domestic crude."* NNPC sells whatever domestic crude is left—usually, between 100,000 and 150,000 barrels per day—to some of its term customers, on terms that are similar to regular export sales.

The result has been growing complexity, with more oil and revenue flowing in more directions through higher numbers of non-transparent accounts and byzantine deals that few outside of NNPC understand (see figure 1). These makeshift systems, the roots of which lie in NNPC's broader structural and financial difficulties, are particularly prone to abuse, and constitute the main objects of our analysis in this report.

As NNPC's financial and operational problems deepened, it introduced more types of makeshift oil sale transactions, many grouped under the domestic crude system.

Reform in the current context

The risks posed by NNPC's approach to selling its oil, both for players in the market and for Nigeria's fiscal and monetary health, are growing. Reform is urgently needed, for the following reasons:

Oil sales are the Nigerian government's largest source of revenues. NNPC oil sales are Nigeria's treasure trove. As in many other oil-exporting developing countries,³¹ sales of oil by Nigeria's national oil company (NOC) are the single largest public revenue source. In 2013, NNPC was responsible for selling an average of 935,629 barrels per day, 43 percent of the country's entire oil production.³² The market value of this oil was equal to 61 percent of total government revenues in the same year.³³ Crude sales dwarf other oil revenue streams such as cash payments from operators for royalties and petroleum profit taxes.

Sales of oil by Nigeria's national oil company are the single largest public revenue source.

Nigeria urgently needs more revenue from oil sales. A confluence of the following macroeconomic and industry pressures has left Nigeria in dire need of higher returns from sales of its oil:

- *Steep socio-economic development imperatives.* Above all, Nigeria should maximize revenues from its oil in order to advance an urgent developmental agenda. Effective management of oil revenues is Nigeria's best shot at delivering the large-scale public health, education and infrastructure investments that its young, fast-growing population needs. As things stand, recurrent expenditures consume all of Nigeria's federal oil revenues; capital budget items must be funded through rising national debt; and poverty rates have climbed.³⁴
- *The oil price shock.* Low oil prices will continue to reduce earnings from NNPC sales in the near- to mid-term, at least. Brent crude has traded between \$50 and \$60 per barrel for much of 2015—or around 40 percent below June 2014 prices, just before the global price decline began. Analysts do not expect a near-term rebound to the \$100+ per barrel prices that prevailed reliably from 2011 to mid-2014.

31 A recent joint NRG-Berne Declaration-Swissaid study found that from 2011 to 2013, the governments of ten sub-Saharan African countries sold over 2.3 billion barrels of oil worth more than \$250 billion, equal to a staggering 56 percent of their combined government revenues. NRG-Berne Declaration, Big Spenders: Swiss Trading Companies, African Oil and the Risks of Opacity 2014, available at: <http://www.resourcegovernance.org/publications/big-spenders-swiss-trading-companies-african-oil-and-risks-opacity>.

32 2013 NNPC Annual Statistical Bulletin.

33 Ibid.

34 For an overview of key statistics, see Budget, Falling Oil Prices: An Opportunity for Reform, December 2014, available at: http://www.yourbudget.com/wp-content/uploads/2014/12/FALLING-OIL-PRICE_Budget_Nigeria.pdf.

- *Weaker demand for Nigerian crude.* Market demand for Nigerian barrels has fallen dramatically, thanks to a glut of light sweet oil in the Atlantic market, weaker refining margins, the return of more Libyan crude to the market, and the collapse of the US market for Nigerian oil.³⁵ Most Nigerian crude sells at a premium to Brent, a widely used pricing benchmark. Those premiums weakened from around a typical \$2.50 per barrel to just 50 cents or less in 2015, and could stay depressed for some time.³⁶ NNPC is now regularly left with significant quantities of unsold oil at the end of each month, some of which only can be sold after further price cuts. Europe and India, which are now the largest markets for Nigeria's oil, probably have limited growth potential.³⁷ Therefore, securing full value from each sale becomes all the more important.
- *Need to rebuild depleted foreign reserves and oil savings.* Unfortunately, Nigeria is not well placed fiscally or monetarily to weather the ongoing price shock and shifts in demand. During the oil price boom of 2011 to mid-2014, the country's external foreign reserves and oil savings actually fell to levels not seen in a decade or more. This was a break from the years immediately preceding, when prices and Nigeria's fiscal buffers moved more or less in tandem (figure 2). By the end of June 2015, gross foreign reserves were at \$29 billion, down from over \$60 billion at the height of the 2008 price spike.³⁸ The Excess Crude Account (ECA) balance was just \$2.087 billion.³⁹

NNPC is now regularly left with significant quantities of unsold oil at the end of each month, some of which only can be sold after further price cuts.

35 Throughout the early 2000s, the US reliably imported around 1 million barrels per day of Nigerian crude— are roughly half of the country's total exports at the time. In 2014, however, only 3 percent of Nigerian exports went to the US. US Energy Information Administration (US EIA) data.

36 Hoping to move a large overhang of unsold February cargoes ahead of releasing the March program in 2015, NNPC COMD cut the February OSPs for some grades to their lowest points in a decade or more. Reference grade Qua Iboe was priced at Dated Brent plus \$0.33 per barrel, down from \$0.65 per barrel in January, and a far cry from the \$3.00 plus premiums that Qua Iboe earned during the second quarter of 2013. Some important grades—notably Brass, Agbami and Amenam—have gone from earning premiums to selling at discounts to Brent. NNPC Monthly OSP sheets on file with NRG.

37 This is due, among other factors, to longer term contractions expected in Europe's refining sector, driven by pressure from US refiners processing cheaper oil, as well as slow macroeconomic growth in Europe and Indian refineries' increasing reliance on cheaper, lower quality crudes from Latin America and elsewhere. Platts, "A tale of two crudes: Nigeria and Angola," May 25, 2015.

38 For data, see <http://www.cenbank.org/intops/Reserve.asp>

39 *Reuters*, "Nigeria to share \$1.7 billion from Excess Crude Account," July 7, 2015. In addition to depleting the ECA, the Jonathan administration made only two major contributions to the Nigeria Sovereign Investment Authority (NSIA) worth around \$1.5 billion. Federation Accounts Allocation Committee (FAAC) data on file with NRG. In 2013, the government had to use N802.984 billion from the ECA to augment revenue allocations to the three tiers. FAAC Technical Subcommittee, Federation Account Income Distribution for the Year 2013.

Average oil price versus savings, 2004-2013

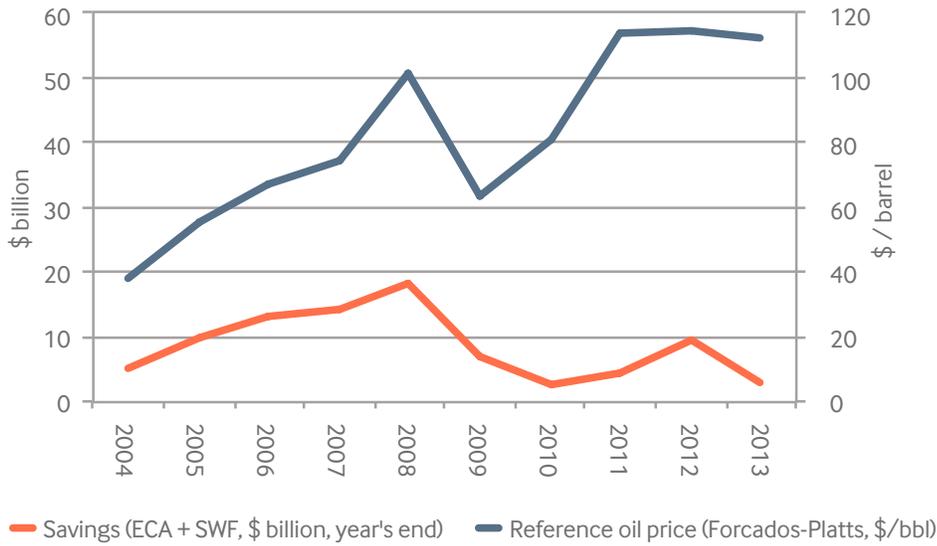
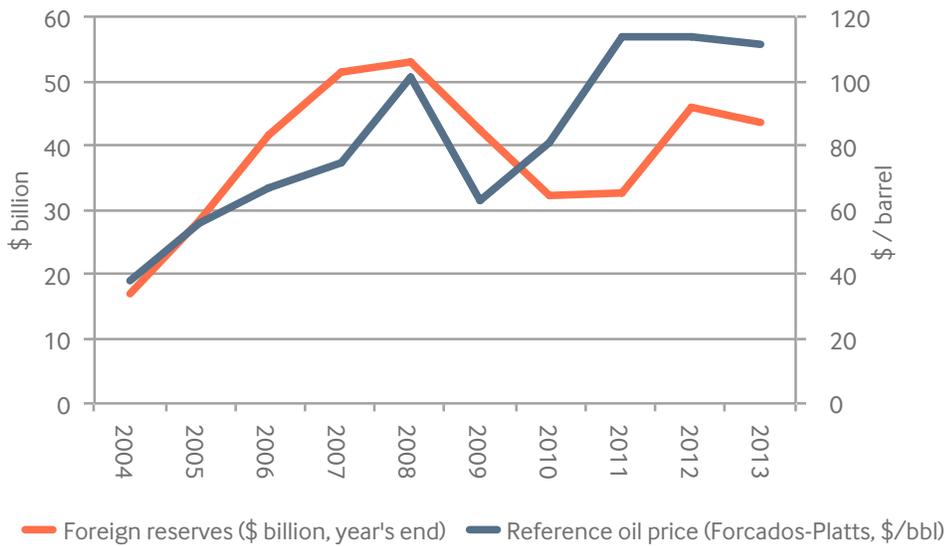


Figure 2. Nigerian average oil prices versus savings and foreign reserves, 2004-2013

Sources: Platts data; IMF Article IV reports

Average oil price versus foreign reserves, 2004-2013



Crude oil theft⁴⁰ and the CBN's efforts to protect the value of the naira⁴¹ accounted for much of the fiscal erosion that started in 2010. Runaway spending, increased borrowing and indifference to saving also played significant roles. Yet NNPC's habit of retaining billions in foreign exchange earnings from its legal oil sales, along with its use of costly transactions like the swaps, have also contributed to the shortage of dollars in Nigeria and with it, the Jonathan government's failure to build adequate buffers. Sanusi told the Senate in February 2014 that "the failure of NNPC to remit foreign exchange to the Federation Account in a period of rising oil prices has made [the CBN's] management of exchange rates and price stability, while keeping reserve buffers adequate, extremely difficult."⁴²

NNPC oil sales also contribute to Nigeria's illicit financial flows problem, which is the biggest in Africa. According to African Union research, from 2000 to 2010 more than 92 percent of the country's illicit financial flows came from the oil sector.⁴³ Oil exports with no recorded public revenue receipts were the largest single point of loss.⁴⁴ Nigeria has rules requiring sellers of petroleum exports to repatriate their foreign currency earnings.⁴⁵ But in practice, NNPC and the buyers of its crude keep much sales revenue in offshore accounts. Some of these are linked to shell companies that buyers use to share profits with "sponsors" in government and other politically exposed persons (PEPs—see p.49-50 for more details).

- *Worsening upstream funding shortfalls and rising costs.* Nigeria also needs more revenue from oil sales to fund ongoing oil exploration and production work in the country. Even before the current fiscal crisis, NNPC was unable to finance its expensive upstream equity holdings. For years, NNPC has fallen short in paying its joint venture cash call obligations, and the gap is growing. In 2015, its JV budget was cut to \$8.1 billion, as compared with a \$13.5 billion allocation in 2014, including a 40 percent cut in capital expenditure.⁴⁶ These shortfalls squeeze revenues in many ways. NNPC borrows from its JV partners to fund its shortfalls, and the associated interest payments further drain potential oil revenues. More fundamentally, the shortfalls starve the industry of the investments needed to increase production and reserves. In the words of one 2012 government task

NNPC oil sales also contribute to Nigeria's illicit financial flows problem, which is the biggest in Africa.

For years, NNPC has fallen short in paying its joint venture cash call obligations, and the gap is growing.

40 Crude theft—discussed at p.69-70, below—and associated production deferrals threaten fiscal stability mainly by pushing production levels below the agreed federal budget oil production benchmark. When this happens, the government is supposed to draw on savings to supplement monthly revenue allocations to the three tiers.

41 Despite progress on economic diversification in recent years, oil still gives Nigeria over 90 percent of its foreign exchange earnings. As such, large oil prices like the current one can significantly weaken the local currency.

42 Sanusi Lamido Sanusi, Memorandum Submitted to the Senate Committee on Finance on the Non-Remittance of the Oil Revenue to the Federation Account ("the Sanusi Senate Presentation)," February 3, 2014, p.3.

43 African Union (AU), Report of the High Level Panel on Illicit Financial Flows from Africa, 2014, available at: <http://www.uneca.org/iff>. The research estimated IFFs from Nigeria at \$217.7 billion between 1970 and 2008. Nigeria had the highest IFFs of any African nation, 30 percent of total IFFs on the continent, and 79 percent in West Africa. The report gave a multi-year average estimate of IFFs as equivalent to 12 percent of Nigeria's gross domestic product (GDP).

44 Id p.97; CLS Stockbrokers, Fixed Income Monthly – "Nigeria's Missing Billions," December 19, 2013. Renaissance Capital also identified an average monthly gap of \$1.5 billion between the value of world imports from Nigeria and claimed exports between January 2012 and May 2013. *Africa Confidential*, "Data Battles in Abuja," February 21, 2014, available at: http://www.africa-confidential.com/article-preview/id/5229/Data_battles_in_Abuja.

45 See e.g., section 19 of the 1996 Pre-shipment Inspection of Exports Act, which stipulates that "an exporter of goods, including petroleum products, shall open, maintain and operate a foreign currency domiciliary account in Nigeria into which shall be paid all exports proceeds corresponding to the entire proceeds of the exports concerned." See also the 1995 Foreign Exchange (Monitoring and Miscellaneous Provisions) Act.

46 Author interviews, oil company and NNPC personnel, 2015.

force: “Output from aging onshore wells is falling 10 to 12 percent a year. NNPC estimates that by 2014, US\$3.7 billion in new drilling costs would be needed annually to simply retain current production levels. [...] Industry analysts forecast production could drop 20 percent by 2020 without additional investment.”⁴⁷

The governance problems associated with NNPC oil sales have intensified.

As detailed throughout this report, the governance of NNPC’s oil sales system has worsened in recent years – just when Nigeria needs to maximize returns from these crucial transactions. As we discuss further in the next section:

- *More oil is being sold through makeshift and opaque mechanisms.* A growing share of NNPC oil sales occur through transactions which deviate from the basic oil sales processes. Senior officials execute these adaptations through processes that lack oversight, transparency, or due process or consultation outside of NNPC. They include the practice of companies paying taxes and royalties with oil instead of money; the crude-oil-for-product swaps; the strategic alliance agreements (SAA) for bankrolling the Nigerian Petroleum Development Company (NPDC), NNPC’s main upstream subsidiary; and oil sold to fund “alternative financing” debts between NNPC and its joint venture IOC partners.

More oil is being sold through makeshift and opaque mechanisms.

The remaining sections of this report outline these practices in greater detail and offer suggestions for reform. But for now, to give a sense of the stakes, figure 3 shows our estimates of the volume of crude flowing through these channels—more than a third of NNPC’s total sales in 2012.

Type of sale	2002		2012	
	barrels per day	% total liftings	barrels per day	% total liftings
Total NNPC sales*	1,107,054	100	1,042,811	100
Sales of equity oil from blocks owned by NPDC, comprised of:				
- Okono crude (OML 119)*	0	0	39,537	3.8
- NNPC Forcados equity oil from ex-Shell JV blocks*	0	0	37,816	3.6
Sales of oil produced under JV alternative finance arrangements or for settling other debts, comprised of:				
- Repayment of Qua-Iboe Modified Carry Agreement+	0	0	31,498	3.0
- Repayment of Qua-Iboe Satellite Project+	0	0	18,220	1.7
- Other third-party debt settlement liftings*	17,944	1.6	0	0
- NPDC crude allocated to alliance partners under SAAs!	0	0	[no data]	[?]
Sales of oil allocated to PPMC’s crude-oil-for-product swaps*	0	0	214,254	20.5
Sales of refinery oil delivered by marine transport+	0	0	38,012	3.6
TOTALS	17,944	1.6	379,337	36.2

Figure 3. NNPC oil sold through makeshift, non-transparent mechanisms, 2002 v. 2012

Sources: NNPC Annual Statistical Bulletins (*); 2012 NEITI Oil and Gas Audit Report (+)
! NRGI could not find a complete, reliable source of data for 2012 SAA liftings

47 Federal Ministry of Petroleum Resources, Report of the Petroleum Revenue Special Task Force (Nuhu Ribadu, chair) (“the PRSTF Report”), p.33.

- Increasing NNPC revenue retention keeps billions of dollars per year from reaching the state treasury.* After rebounding from the oil price slump of 2008-2009, market prices for Nigerian oil stayed stable and high for several years. Average prices for the country’s light sweet crude topped \$110 per barrel during the boom of 2011-2014. Yet during that same period, treasury receipts from oil sales fell dramatically (figure 4).

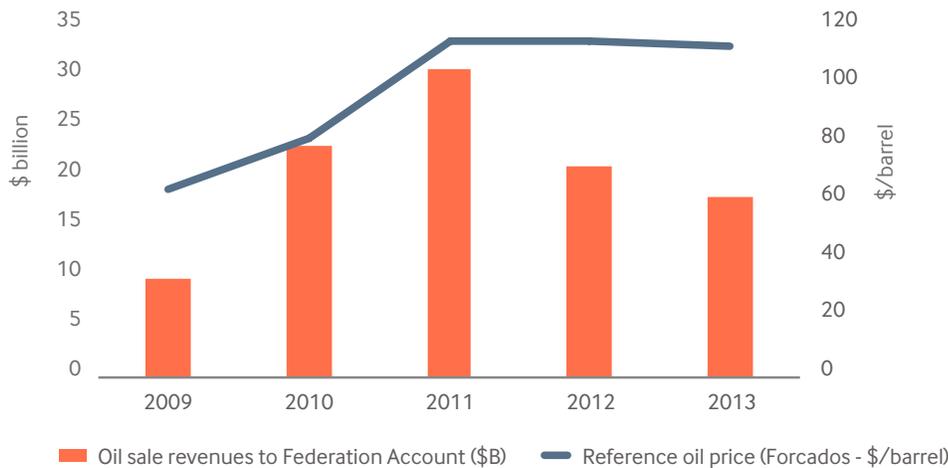


Figure 4. Oil prices versus Federation Account oil sale receipts, 2009-2013

Sources: Federal Budget Office Budget Implementation Reports; Platts data

While lower exports (reduced mainly by oil theft) explain some of the drop-off, two features of the NNPC oil sales regime are also to blame.⁴⁸ First, the corporation is allocating more oil to the complicated, non-transparent deals highlighted above, deals which fail to maximize returns for the crude it sells. At the same time, NNPC is holding back ever-growing sums from the treasury; withholdings totaled over \$25 billion from domestic crude sales alone between 2010 and 2013.⁴⁹ In 2014, auditors for PriceWaterhouseCoopers (PwC), after reviewing the corporation’s oil sales, wrote: “[NNPC has a] ‘blank’ cheque to spend money without limit or control. This is untenable and unsustainable and must be addressed immediately.”⁵⁰ This issue of NNPC withholdings is discussed in the next sections, and in annex A on the domestic crude allocation.

The transition in leadership may help disrupt the political capture of NNPC.

NNPC is a well-established venue for the broader patronage and corruption patterns that weaken accountability and good governance in Nigeria. During a period when some NOCs expanded their operations into other countries, NNPC failed to capitalize on high prices and growing demand for African crude. Instead, its governance systems have evolved in a manner that enables politically powerful actors to access and distribute short-term benefits from the company’s operations.⁵¹ Characteristics that

48 No fully reliable public figures for losses from oil theft exist, but one report estimated theft levels at 100,000 barrels per day for the first quarter of 2013. Sayne and Katsouris Oil Theft Report p.21f.
 49 See figure 6. Calculation relies on data from NEITI audit reports and NNPC submissions to FAAC.
 50 PwC, Investigative Forensic Audit into the Allegations of Unremitted Funds into the Federation Accounts by the NNPC (“the PwC Report”), February 2015, p.16.
 51 See e.g., Mark Thurber, Ifeyinwa Emelife and Patrick Heller, NNPC and Nigeria’s Oil Patronage Ecosystem, Working Paper, September 2010, p.2f., available at: http://fsi.stanford.edu/sites/default/files/WP_95_Thurber_Emelif_Heller_NNPC_16_September_2010.pdf; G. Ugo Nwokeji, The Nigerian National Oil Company and the Development of the Nigerian Oil and Gas Industry: History, Strategies and Current Direction,” James A. Baker III Institute for Public Policy, Rice University, March 2007, p.12f., available at: http://bakerinstitute.org/media/files/page/9b067dc6/noc_nnpc_ugo.pdf.

define NNPC’s approach to oil sales—including excessive discretion amongst officials, a surplus of middlemen, uneven information flows and weak oversight—ensure that these transactions benefit actors operating within the Nigerian patronage system; such a system fails to maximize current and future revenues for the benefit of the public.

Nigeria’s recent leaders have not invested much political capital in reforming NNPC—even after receiving the well-publicized, dramatically negative findings of task forces and review committees which the leaders themselves commissioned.⁵² Instead of prioritizing the long-term growth of the sector, NNPC officials have focused instead on business transactions that add little value over the long term, but that present narrow, near-term opportunities. “NNPC operations are disproportionately concentrated on oil marketing and downstream functions, which offer the best opportunities for private benefit,” the authors of a 2010 study concluded. In such an environment, employees have “few incentives [...] to be entrepreneurial for the company’s benefit.”⁵³ In this environment, the governance of oil sales has worsened, and vested interests have obstructed the reform of the sales.

The 2015 election and the installation of a new government in Abuja are opportunity to disrupt this pattern. While many of the interests that benefit from NNPC’s systems remain powerful in the new political dispensation, the inauguration of President Buhari presents an opening nonetheless. Popular expectations are high, particularly given the president’s reputation as an enemy of corruption, and beneficiaries of the status quo are braced for change. While far from guaranteed, the present moment may engender the kind of political will needed to tighten NNPC governance and boost the incentives for performance and against abuse.

Outside scrutiny of NOC oil sale governance is growing. This positive trend means that governance problems in this area can no longer persist quietly and unnoticed. The sale of crude oil by governments and their NOCs has historically been one of the least scrutinized parts of oil sector governance. Despite their great importance for countries like Nigeria, NOC oil sales are not well understood outside of industry circles. The media covers oil sales less—and less competently—than upstream activities. Several national laws that require extractives companies to disclose payments made to countries exempt NOC oil sales.⁵⁴ The global physical spot market, where most of Nigeria’s oil trades, is a vast, labyrinthine, and largely unregulated space.

The present moment may engender the kind of political will needed to tighten NNPC governance and boost the incentives for performance and against abuse.

52 As one 2008 government panel wrote, NNPC “operates as a huge amorphous cost centre with little or no sensitivity to the bottom line.” Nigerian Presidency, Oil and Gas Sector Reforms Implementation Committee Final Report (“the OGIC 2 Report”), July 2008, p.7. In the words of a 2012 government panel: “NNPC’s fiscal health has weakened dramatically in recent years. Between 2007 and 2009 the Corporation’s closing net balance sheet liabilities grew from ₦952bn to ₦1.36tn. [...] NNPC’s asset base appears stagnant from age and absence of strategic investment.” PRSTF Report p.104; see also KPMG-S.S. Afemikhe, Final Report on the Process and Forensic Review of the Nigerian National Petroleum Corporation (Project Anchor), Volume One – Executive Summary & Main Report (“the KPMG Project Anchor Report”), 2011, sec.7.2.

53 Thurber, Emefile and Heller (2010, op.cit.), p.6.

54 Notable among these are Section 1504 of the 2010 U.S. Dodd-Frank Wall Street Reform and Consumer Protection Act and similar rules propounded by the European Union (EU) and Canada.

But outside actors are becoming more attuned to NOC oil sales. Some private commodities trading companies have been called out and investigated for offenses, from sanctions-busting to manipulation of benchmark oil prices and environmental damage.⁵⁵ Now foreign intelligence services, prosecutors and police are taking more notice—a trend that could continue.⁵⁶ Civil society’s work on physical commodity sales is also maturing. Recent investigative reports by NGOs garnered significant attention—including in Nigeria.⁵⁷ In 2013, the Extractive Industries Transparency Initiative (EITI) called on participating countries to reveal more information about their oil sales, a practice which has already begun in several countries.⁵⁸ Although many questions will likely remain unanswered, the era of near-total secrecy around oil trading in developing countries like Nigeria is over.

The era of near-total secrecy around oil trading in developing countries like Nigeria is over.

Nigeria is illustrative of this trend. The 2012 scandal around the fuel subsidy drew unprecedented attention to how NNPC manages its petroleum import and export procedures. The “missing \$20 billion” oil sales scandal followed in late 2013. (See annex A for a full account.) In 2015, NNPC’s oil-for-product swap deals have drawn attention, with extensive media coverage and inquiries initiated by the anti-corruption police and the legislature.

More scrutiny means higher reputational risks for the players involved. Along with the Nigerian government, the buyers of Nigerian crude and the companies that finance their purchases also face legal sanctions and reputational damage if they are found to support rogue actors or bad deals. Attributes of the current system, such as transactions that leave space for politically exposed middlemen, could create issues for buyers and sellers—both traders and refiners—under anti-bribery statutes like the US Foreign Corrupt Practices Act or the UK Bribery Act.⁵⁹ More generally, the steady stream of critical reports detailing the problems with NNPC oil sales has increased the scrutiny which companies involved in oil sales face, both in the market and from law enforcement. The fallout from this, in turn, could damage the reputations of government officials, the banks that finance and trade NOC oil shipments, the trading divisions of some IOCs, the private inspection agencies that sign off on shipments at ports, and the shipping companies that transport oil.

55 For an overview of some past cases, see Berne Declaration, Commodities: Switzerland’s Most Dangerous Business, 2012, available at: https://www.ladb.ch/fileadmin/files/documents/Rohstoffe/commodities_book_berne_declaration_lowres.pdf.

56 To illustrate the wider trend: The US government in November 2012 launched its second Foreign Corrupt Practices Act (FPCA) investigation against a commodities trading house with a probe of alleged bribes paid by agricultural trading giant Archer Daniels Midland. Swiss officials in 2012 announced they were probing the activities of a former Gunvor executive for money laundering related to purchases of \$2 billion worth of crude from the NOC of the Republic of Congo at a discounted price of \$4 per barrel. *Le monde*, “L’affaire Gunvor ou l’anatomie d’un scandale pétrolier russo-congolais,” June 3, 2013, available at: http://www.lemonde.fr/international/article/2013/06/03/l-affaire-gunvor-ou-l-anatomie-d-un-scandale-petrolier-russo-congolais_3422789_3210.html. For an example of a recent NGO reporting, see e.g., Global Witness, Azerbaijan Anonymous, December 2013, available at: <https://www.globalwitness.org/archive/azerbaijan-anonymous/>.

57 See e.g., Berne Declaration, “Press release: BD oil report triggers parliamentary investigation in Nigeria,” available at: https://www.bernedeclaration.ch/media/press-release/press/bd_oil_report_triggers_parliamentary_investigation_in_nigeria/.

58 See EITI, The EITI, NOCs and the sale of the government’s oil, available at: <https://eiti.org/document/eiti-brief-nocs-and-sale-government-oil>.

59 For a discussion of the risks of payments to politically exposed persons (PEPs) in NNPC oil sales, see pages 49-50.

Figure 5 illustrates the diversity of private sector actors involved in NNPC oil sale transactions, all of whom would face lower risks if governance practices improved.⁶⁰

Financial institutions that issued letters of credit	Refiners that bought crude originally sold by NNPC
ABN Amro, Netherlands	Bharat Petroleum Corp., India
Access Bank, Nigeria	British Petroleum, UK
BNP Paribas, France	Cepsa, Spain
Comerzbank AG, UK	ConocoPhillips66, US
Crédit Agricole, Switzerland	ExxonMobil, US
Credit Suisse, Switzerland	Indian Oil Corp., India
First Bank, Nigeria	Litasco, Switzerland
ING, Belgium	OMV, Austria
Natixis, France	Pertamina, Indonesia
Rabobank, Netherlands	Petrobras, Brazil
Société Générale, France	Petroineos, France
Standard Chartered, UK	Repsol, Spain
Sumitomo Mitsui Banking Corp., Japan/Belgium	Sasol, South Africa
UBA, Nigeria	Shell, Netherlands
Unicredit Bank, Italy	Societe Africaine d’Raffinage (SAR), Senegal
	Societe Ivoirienne d’Raffinage (SIR), Côte d’Ivoire
	Sonara, Cameroon
	Sunoco, US
	Tema Oil Refinery, Ghana
	Total, France
	Tupras Refinery, Turkey

Figure 5. Significant financiers and refiners of marketed NNPC crude oil, 2011-2014⁶⁰

Sources: Ministry of Finance pre-shipment inspection reports; market data

Taken together, these contextual factors combine to make the reform of NNPC oil sales a national priority for Nigeria. In the sections that follow, we detail specific areas on which reformers might focus their attention.

60 NB: The list may not be complete, as data was not available for all cargoes lifted.

Targeting urgent problems with NNPC crude sales

For Nigeria to secure full value from selling its crude oil, we propose a two-track reform agenda. For the first track, described in this section, the new government should urgently fix the worst sales practices, plugging leaks and stemming abuses of power. The first five recommendations pertain to this agenda (“stop the bleeding”). With concerted political will, many of these steps could take place within one to two years.

Second, NNPC should be required to fix certain underlying structural problems, otherwise a fresh system of equally inefficient, exploitable, makeshift measures and coping mechanisms will crop up. The next section details these broader efforts (“cure the patient”).

For each of the five urgent issues, we detail why the existing practices do not adequately serve the public interest. Our analysis does not offer a comprehensive “framework” or “roadmap” for revamping NNPC’s oil sales system. Nonetheless, we believe we have correctly identified the most important changes to make, in particular those that respond to the sector’s governance challenges, like political interference and conflicts of interest, rather than just technical concerns. The case for the recommendations emerges from our review of all of the major reports about the oil sector issued since the 2000s; analysis of extensive oil sales and oil revenue data; and discussions with a wide range of stakeholders – including government, private sector, and civil society actors– within and outside of Nigeria.

A few cross-cutting comments about this agenda are as follows:

- NNPC’s performance challenges and discretionary withholdings from oil sales almost certainly lose more money for Nigeria each year than any fiscal weaknesses in contracts with IOCs, and therefore should be first in the queue of oil sector reform measures.
- The agenda we propose does not require omnibus legislation like the Petroleum Industry Bill (PIB) to move forward. In fact, as has become evident over the past seven years, a far-reaching law of that kind acquires immense political baggage, and requires significant time for implementation.
- In reforming oil sales, the government would benefit from prioritizing simplicity throughout. Current governance problems throughout the sector – from subsidy scams to tax collection to the swap agreements – thrive on complex and murky arrangements that only a handful of people understand.
- The bad practices that undermine NNPC oil sale performance all feature political interference at their root. Entrenched, high-level meddling in financial, contracting, corporate governance and operational decisions has led to transactions and revenue collection habits that reward a privileged few over the Nigerian citizenry which owns the oil.

For Nigeria to secure full value from selling its crude oil, we propose a two-track reform agenda.

The bad practices that undermine NNPC oil sale performance all feature political interference at their root.

- Quick technical changes to the sales system, new contracts or leadership changes at NNPC will not address the real problems.
- NNPC requires deeper reforms: new institutional structures for sales, finance and broader corporate decision-making, together with fresh incentives, political independence and accountability for whomever will work within the structures going forward. This idea underpins all of the recommendations we offer.

Reform has not come easily to NNPC oil sales. Even acknowledging some very important and arguably beneficial technical changes,⁶¹ in particular the introduction of OSPs in the 1980s, the decision-makers in and outside of the corporation have resisted insistent calls for reform during recent years. Nonetheless, the current conditions in the sector and the country overwhelmingly favor reform, which should involve the following six components. For each, we outline the shortcomings with the current system in order to justify why change is required.

<div style="display: flex; align-items: center;"> <div style="background-color: #e67e22; border-radius: 50%; width: 40px; height: 40px; display: flex; align-items: center; justify-content: center; margin-right: 10px;"> issue 1 </div> <div> <h3 style="margin: 0;">The Domestic Crude Allocation (DCA)</h3> </div> </div>	
Problems	<ul style="list-style-type: none"> • The DCA has become the main nexus of waste and revenue loss from NNPC oil sales. In 2013, the Federation Account (Nigeria’s treasury) received only 58 percent of this oil’s \$16.8 billion value. • The DCA was designed to feed Nigeria’s refineries, but in practice NNPC exports three quarters of the so-called domestic crude. • NNPC’s discretionary spending from domestic crude sale revenues has skyrocketed, exceeding \$6 billion a year for the 2011 to 2013 period. • NNPC’s explanations for how it spends the revenues it retains are incomplete and contradictory, and the spending (such as on the fuel subsidy and downstream operations) delivers poor value for money.
Recommendation	The government should eliminate the DCA, which creates more problems than it solves.

The Nigerian government should end the DCA. Over time the mechanism—which consumes roughly a fifth of the crude that the country produces—has grown into arguably the single biggest point of waste and revenue leakage in public oil revenues. A shelf of prior reports called for reforms, but none have followed.

Our research on the DCA—which annex A lays out in detail—finds five reasons to eliminate it:

- *The DCA’s design has little bearing on its current use.* It makes little sense for NNPC to sell 445,000 barrels per day to PPMC, ostensibly to feed the country’s refineries, when they usually process only 100,000 barrels per day, or less. NNPC ultimately re-routes most DCA oil into export sales or swaps, payments from which go into separate NNPC accounts, which NNPC officials then spend from freely.

61 These include the introduction of OSPs after the collapse of the OPEC pricing system, abandonment of long-term offtake agreements in favor of one-year term contracts, and the favoring of private oil traders as buyers over IOCs.

- NNPC is retaining more DCA revenues in recent years; the treasury is receiving less.* By analyzing data NNPC submitted to NEITI and the Federal Account Allocation Committee (FAAC), we found evidence of a dramatically widening gap over time between the sales value of domestic crude, as assessed by NNPC, and transfers of DCA revenues to the Federation Account. In 2004, for example, NNPC retained over \$1.6 billion, or 27 percent of the DCA’s full assessed value. By 2012, the figure had jumped to a remarkable \$7.9 billion—or 42 percent of the value of the domestic oil for that year (figure 6). Although these figures come with some caveats,⁶² we believe they are sufficiently solid to show that NNPC’s habit of unilaterally withholding DCA revenues has reached runaway, unsustainable levels—especially now that Nigeria is facing an oil price slump, a depleted treasury, weakened demand for its crude and rising upstream oil sector costs.

Figure 6: Reported domestic crude sales earnings versus treasury receipts, 2004-2013

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
(a) Total DCA liftings										
('000 barrels)	151,893	159,899	155,068	157,312	164,724	161,914	166,523	164,454	162,343	156,192
(b) Annual sales value of all DCA liftings, calculated by NNPC										
(₦ million)	759,653	1,145,361	1,258,539	1,431,175	1,809,451	1,451,586	1,954,124	2,776,893	2,812,051	2,657,240
(\$ million)	5,935	8,743	10,599	11,531	15,562	9,903	13,229	18,363	18,260	16,818
(c) Annual transfers to the Federation Account										
(₦ million)	573,483	772,227	1,037,564	1,037,751	1,419,351	850,833	1,391,378	1,835,249	1,594,915	1,551,935
(\$ million)	4,312	5,578	8,235	8,359	12,213	5,788	9,401	12,154	10,357	9,822
(d) Estimated value of DCA oil that did not reach the Federation Account [(b) - (c)]										
(\$ million)	1,623	3,165	2,364	2,992	3,349	4,115	3,828	6,209	7,903	6,996#
percentage of total	27	36	22	26	22	42	30	34	43	42

Sources: For 2004-2012, the data for (a) Total DCA liftings and (c) Annual transfers are taken from NEITI financial audit reports, or are conversions based on average exchange rates. For 2013, the (a) Total DCA liftings and is drawn from the 2013 NNPC Annual Statistical Bulletin, and (b) Annual sales value and and (c) Annual transfers from NNPC Report: Reconciled Receipts of Domestic Crude Cost, January 2013-date, and NNPC Report: Computation of Revenue from Domestic Crude Oil Receipts, January 2013 to Date. Some columns may not total due to rounding.

- NNPC administers the DCA with few rules and weak oversight, causing chronic confusion.* The corporation exercises excessive levels of discretion over how to sell domestic crude, whether to remit the resulting revenues to the treasury, and how to spend the funds that it keeps. It withholds billions of dollars each year with unclear legal authority and no defined repayment plan. NNPC retains several billion dollars a year for subsidized kerosene sales, for instance, despite a 2009 presidential directive calling for an end to the kerosene subsidy.⁶³ NNPC and PPMC do not even have a contract governing DCA sales.⁶⁴ In terms of reporting, NNPC’s narratives about where the money goes are incomplete and uneven. Past audits showed it claiming hundreds of millions of dollars in duplicated or undocumented expenses—totaling \$2.07 billion in nineteen months, according to PwC.⁶⁵ We could find no evidence that

62 We rely on average annual exchange rates, and rounded some figures. Also, as NNPC has three months to pay for domestic crude, we could not always discern whether the totals accounted for payments made by NNPC during the subsequent year due to this time lag. We also could not independently verify NNPC’s figures for accuracy. See annex A for more detail.

63 For an account of this controversy, see PwC Report p.17.

64 NEITI, 2012 Oil and Gas Audit Report p.202.

65 PwC Report p.13.

NNPC discloses to other government agencies what buyers of domestic crude actually pay; PwC recently found that the corporation under-reported DCA earnings to FAAC by an unknown amount.⁶⁶ According to our analysis of NEITI and FAAC data, NNPC gave no timely explanations at all for revenue withholdings that ranged from \$270 million to nearly \$7 billion per year. (See annex A, figure A7.) Controversies and competing claims, such as the one prompted by former CBN governor Lamido Sanusi’s accusations of a “missing \$20 billion,” thrive in this shadowy context. More than half—\$12 billion—of the alleged \$20 billion in “missing” revenues were from domestic crude sales.

NNPC gave no timely explanations at all for revenue withholdings that ranged from \$270 million to nearly \$7 billion per year.

- *NNPC spending from of the DCA delivers poor value, shows signs of mismanagement.* The corporation claims it holds back domestic crude earnings as a makeshift way of covering its downstream-related operational costs and subsidies.⁶⁷ But our research finds serious cause to doubt whether its spending delivers value for money. Unilateral, unaccountable fuel subsidy withholdings are the largest “black box” in NNPC’s DCA withholdings. Past practices suggest that the amounts withheld exceed actual subsidy costs. KPMG, for example, found that for the 2007-2009 period, NNPC paid itself ₦885.89 billion (roughly \$6.5 billion) for subsidies on 15.6 billion liters of gasoline, kerosene and diesel that “apparently were not available to the Nigerian market.”⁶⁸ According to NNPC’s own data, theft from some of its crude oil pipelines actually rose—in some cases by over 500 percent in a year—after the company claimed to spend hundreds of millions in DCA earnings to protect them (See annex A, figure A10). Starting in 2011, the corporation entered into expensive arrangements—costing \$7.52 per barrel, by one estimate—to transport oil to the refineries by ship (see p. 33-34), yet refinery outputs during the period did not improve.
- *The DCA creates a conflict-of-interest, with NNPC acting as buyer and seller.* When NNPC allocates “domestic crude” on an intercompany basis to PPMC, whether for use in refining, swaps or export sales, it creates a situation where the corporation is essentially selling to itself. This leaves NNPC with no incentive to charge top prices. And indeed, many past audits and investigations reported that NNPC shortchanged the nation in domestic sales by using low exchange rates to convert dollar payments into naira, and by selling the crude at “discounts.”

As a result of these problems we recommend that the Buhari government:

Eliminate the DCA.

There is no good reason to keep the DCA as a separate store of oil and money. Nigeria has other, better options for feeding the refineries, ensuring ample fuel supplies and covering downstream costs. (See issues two and three, below.) Especially right now, as the country faces tough fiscal challenges, leaving open such a large revenue drainpipe threatens the nation’s economic health. There is no law establishing the DCA, thereby facilitating its removal.

66 PwC Report p.58.

67 For example, NNPC told PwC that it held withheld 46 percent of the value of DCA oil sold between January 2012 and 2013 for these two reasons. Id. p.12

68 KPMG Project Anchor Report sec.6.3.4.

Devise a new model for supplying the refineries with crude oil; exclude PPMC from sales.

Even if the government eliminates the DCA, NNPC's refineries will still need crude oil. We recommend that PPMC be excluded from future refinery sales, given its poor record managing them. (See annex A). NNPC itself could still remain the refineries' largest, or even sole supplier under several possible models.⁶⁹ These include tolling, where NNPC would grant the refineries operational independence and lease refining capacity from them in exchange for providing crude; a repurchase agreement, under which the corporation would buy crude from its upstream partners on behalf of the refineries;⁷⁰ and further parent-subsidiary sales, with volumes capped at the refineries' actual needs. Forcing the refineries to buy their own oil from upstream operators is another option, though some firms would balk at doing business with the underperforming, cash-strapped plants, especially at first.⁷¹ The government could pass legislation to force the IOCs or other operators to sell parts of their equity production to the refineries, but this would be controversial.⁷² Finding the best transaction type depends in part on whether the government plans to change the refineries' ownership and management structures—for example, by signing product sharing and technical service contracts with competent foreign refining companies, or by selling off equity to a private investor through a formal privatization exercise.⁷³ (For more on our recommendation to privatize NNPC's downstream businesses, see pages 67-69.)

We recommend that PPMC be excluded from future refinery sales, given its poor record managing them.

Review and reform the refinery oil marine transport arrangements.

In a purported effort to bypass theft from its refinery supply pipelines, NNPC in 2011 began transporting oil to the Warri refinery by ship. A similar arrangement for the Port Harcourt plant followed in 2014. In August of that year, former petroleum minister Alison-Madueke announced that NNPC was spending an average of \$7.52 per barrel to transport domestic crude to the refineries by ship.⁷⁴ Previously, PPMC had charged the government only N0.30/liter (or roughly \$0.03 per barrel) to move oil through the refinery lines.⁷⁵

Information on the terms of these marine transport deals remains scarce. NNPC records show the corporation kept pumping crude through the Escravos-Warri refinery pipeline well after the ship transport arrangements started—even though the arrangements were supposedly set up because the line was hemorrhaging too much oil.⁷⁶ Some of the vessels

Information on the terms of marine transport deals remains scarce.

69 Note that under current law, the Petroleum Minister has broad power to determine crude supplies to the refineries. 1969 Petroleum Act sec.9(1)(d).

70 For example, section 165(a) of the 2010-11 Interagency Team draft of the PIB envisioned NNPC, as a shareholder in incorporated joint ventures, having a first refusal-like option to purchase crude from its JV partners.

71 Author interviews, NNPC officials and executives at Nigerian upstream oil companies, 2012-14.

72 Ibid.

73 Federal Ministry of Petroleum Resources, Report of the Refineries Special Task Force (Kalu Idika Kalu, chair) ("the Kalu Task Force Report"), 2012, p.42.

74 *Platts*, "Nigeria's refining costs up on transporting crude oil by ship: minister," August 6, 2014, available at: <http://www.platts.com/latest-news/oil/lagos/nigerias-refining-costs-up-on-transporting-crude-26851625>. For more on this topic, see annex A p.A19.

75 Kalu Task Force Report p.40.

76 In October and November 2013, for example, NNPC sent 159,191 barrels of Escravos crude worth \$17.6 million through the line. NNPC, Crude Oil Lifting Profiles for Domestic Consumption, October and November 2013.

involved also sat anchored offshore the Niger Delta—presumably at a significant cost to the nation—for long periods when NNPC was not sending crude to the refineries at all.⁷⁷ We wrote to a director and shareholder of PPP Fluid Mechanics, one of the companies involved in the arrangements, asking for information, but did not receive a reply.

<div style="display: flex; align-items: center;"> <div style="background-color: #e67e22; border-radius: 50%; width: 40px; height: 40px; display: flex; align-items: center; justify-content: center; margin-right: 10px;"> issue 2 </div> <div style="background-color: #2c4e64; color: white; padding: 5px 10px; font-weight: bold;">Revenue retention by NNPC and its subsidiaries</div> </div>	
Problems	<ul style="list-style-type: none"> • NNPC has invented a makeshift system for financing its operations, and is discretionarily retaining ever-growing sums. • NNPC’s five oil trading subsidiaries have acquired no independent trading capacity, but act as passive middlemen on large sales volumes (144,010 barrels per day in 2012, worth \$5.9 billion). NNPC does not disclose what happens to the commissions earned by the subsidiaries on these sales. • Available records indicate NNPC retained revenues from the sale of 110 million barrels of oil over ten years from one block controlled by its subsidiary NPDC, worth an estimated \$12.3 billion.
Recommendation	<p>The government should develop an explicit revenue collection framework for NNPC that facilitates more predictable financing and reins in discretionary spending.</p>

NNPC withholds DCA funds in part because there is no other established method for financing its operations. Most countries establish an explicit rule for national oil company financing. For instance, Malaysia’s Petronas retains profits on earnings, but transfers royalties, dividends and export duties to the state, as well as paying a set tax rate on its own profits. Ghana’s GNPC can retain “equity financing costs” and additional amounts approved by parliament, but these cannot exceed 55 percent of net cash flow from government assets.

Without such a mechanism, NNPC cobbles together funds from multiple sources. Spending from withheld DCA revenues is described above. The federal government also allocates to NNPC a portion of export sale revenues which are intended to fund the joint venture cash calls (see figure 1). NNPC spends a portion of these funds in a discretionary manner on non-cash call expenses – as detailed below. Some of NNPC’s revenue generating subsidiaries also retain their revenues, or transfer them to NNPC’s central accounts where they are spent – rather than entering the Federation Account. The amount of revenues retained by NNPC subsidiaries is unknown. In addition, NNPC sources financing from third parties to cover expenses. The amount of debt presently owed by NNPC is also unknown.

Paradoxically, this *ad hoc* way of operating at once impoverishes NNPC, leaving it chronically indebted and short of operating funds, and gives it far too much discretion to retain ever-growing sums from oil sale proceeds. The arrangements have grown more confusing, opaque and abuse-prone as types of sales have proliferated. Nigeria’s executive branch has left top officials far too free to intervene and re-route money in questionable directions—and in some cases, directed them to do so.

⁷⁷ Finding based on a comparison of NNPC oil sale records with commercial tanker reports, other market intelligence data, and satellite vessel tracking data on file with NRGIL.

Going forward, a more airtight system for collecting oil sale proceeds will not by itself guarantee Nigeria full and fair value. Money can still vanish earlier or later in the decision chain, through cost inflation, bad contracting and poor investment decisions. Moreover, NOCs with too much autonomy over their own revenues do not always deliver the best returns to the country.⁷⁸ This report does not offer a complete set of recommendations for reforming NNPC's revenue collection system. The details of any new plan would depend on bigger, overdue decisions on how to restructure and fund operations going forward.⁷⁹ But we posit that any successful model should, at the very least, do the following:

Establish the legal basis for NNPC withholdings, and resolve the conflict between the constitution and the NNPC Act

Section 162 of Nigeria's 1999 Federal Constitution requires that all government-collected revenues enter the Federation Account. Contrast this with Section 7 of the 1977 NNPC Act, which broadly allows the corporation to maintain a "fund" to bankroll its operations. NNPC has used the resulting confusion to retain money by fiat, outside of regular public financial management controls.

Along with resolving this apparent contradiction, it is necessary to create an explicit rule for how NNPC should fund its operations. This could be done through an amendment to the NNPC Act which spells out which funds NNPC can retain in greater detail than the current provision, as well as how they can be used, and the checks and balances on this expenditure. This report does not provide precise prescriptions for how to achieve this, such as how to structure tax or dividend payments by the corporation; the appropriate choices would depend on how NNPC is restructured going forward (see page 69). However, national oil companies around the world offer models that Nigeria could adapt, and some critical basic steps would include:

It is necessary to create an explicit rule for how NNPC should fund its operations.

- Carrying out an operational assessment, complete with a multi-scenario revenue modeling exercise, to identify proper and improper types of expenditures for NNPC, and their likely levels over the coming years.
- Defining a withholding or allocation system that would allow NNPC, its company partners and the country to plan with some predictability, and that creates financial incentives in favor of efficiency and performance.⁸⁰
- Strengthening NNPC's internal cost control mechanisms, both through better *ex ante* functions like budgeting and cost benchmarking and *ex post* verification and audit functions.
- In the near term, before a comprehensive NNPC restructuring takes places, the key would be to explicitly establish what funds can be withheld and strict guidelines on what is *not* allowed.

78 In Angola, for example, Sonangol has huge de facto authority to spend its own oil revenues. In 2014, IMF analysis found an "unexplained residual" in state accounts of over \$31 billion between 2007 and 2010 that had been spent outside of ordinary public financial management rules. Further analysis attributed most of the losses to quasi-fiscal activities by Sonangol and the transfer of oil revenues "to external accounts to service external credit lines." IMF, Angola: Second Post-Program Monitoring: Press Release and Statement by the Executive Director for Angola, IMF Country Report No. 14/81, March 2014, available at: <http://www.imf.org/external/pubs/ft/scr/2014/cr1481.pdf>.

79 For more on these challenges, see Section 6 of this report.

80 Options include secondary profits taxes on NNPC (as Mexico does with Pemex) or a rule allowing the corporation to retain certain maximum percentages of revenues from different revenue streams (as is used in Kuwait and Ghana).

Place strict legal and operational limits on extra-budgetary spending.

NNPC rampantly spends oil sales receipts in an off-budget manner. The corporation and its subsidiaries do draw up annual budgets, some of which go to parliament and other agencies for review. Yet these documents do not always match reality. Top officials have virtually unchecked discretion over the size, sources and nature of expenditures. Each year, the corporation's leadership chooses not to fully fund some important line items in its budget, then re-routes billions of dollars to cover purported costs that are *not* mentioned in the budget. From the available information, we cannot calculate the magnitude of the problem. The ballooning withholdings of DCA proceeds give some sense of its scale, and how it is worsening.

The corporation's leadership chooses not to fully fund some important line items in its budget, then re-routes billions of dollars to cover purported costs that are not mentioned in the budget.

Discretionary spending is not confined to the DCA: it is the norm in NNPC's upstream operations as well. The corporation makes its share of JV cash call payments mostly out of export oil sale proceeds. To determine the size of cash calls, each year the JV companies and several offices in NNPC—most notably the National Petroleum Investment Management Services (NAPIMS)—develop and agree on annual work programs and budgets. These documents are supposed to govern how much each party must pay into the JV cash call account for the year, and how those funds are used.⁸¹

However, NNPC routinely uses money from the JV account for items not found in any work program or budget. NEITI identified roughly \$4.2 billion in such payments between 2009 and 2012.⁸² Earlier, a report from the Nigerian auditor-general's office found that in 2007 alone, roughly \$2.2 billion was "irregularly diverted [...] for execution of programmes and activities not included in the approved budgets of the JV operators."⁸³ This came on top of other significant, largely unexplained irregularities in the management of the JV cash call account totaling approximately \$2.6 billion.⁸⁴

This pattern of behavior suggests that NNPC's long history of diverting funds into questionable "special" or "priority" projects has not ended. Off-budget spending from its JV accounts and DCA earnings represent red flags requiring urgent attention.⁸⁵

81 For more detail on how the cash call process works, see NEITI, 2006-08 Oil and Gas Reconciliation Report, Appendix M.

82 More specifically, NEITI uncovered \$600 million in "security payments," \$646.95 million for the "Expansion of Escravos-Lagos Pipeline Project," and \$486.6 million in NAPIMS "management fees." NEITI, 2009-2011 Oil and Gas Financial Audit Report p.19. In its 2006-2008 audit, NEITI found similar payments for security and management fees that it could not support with "invoices, receipts or other documents." NEITI, 2006-08 Oil and Gas Reconciliation Report, Appendix M, sec.1.14.KPMG also questioned NAPIMS's practice of withholding large "management fees" from the JV account in its audit of NNPC accounts from 2007-2009, noting that NNPC "did not provide the auditors with authorization or supporting documentation" for \$384 million in such withholdings. KPMG Project Anchor Report sec.5.3.8.

83 Auditor-General of the Federation, Report of the Auditor-General for the Federation to the National Assembly on the Accounts of the Government of the Federation for the Year Ended 31st December 2007, Sec. 3.32. The line items included "performance Balance/supply, Niger Delta Security Arrangement, NIPP projects and NAPIMS Overhead Cost." Id.

84 For instance, the Auditor-General reported that for 2007, total cash call payments exceeded approved overheads by N108.826 billion (\$877 million); federal budget appropriations worth \$336 million more than the combined JV budgets; a further unexplained extra-budgetary transfer of \$1.3 billion in February 2007; and \$50.436 million in interest earned on the JV cash call account balance that apparently was not remitted to the Federation Account. 2007 Id., sec.3.27, 3.29, 3.32-33. KPMG in its 2010-11 audit also queried the non-remittance of \$73 million in interest between 2007 and 2009. KPMG Project Anchor Report, sec.5.3.1.

85 This legacy dates back to the late military period of the 1980s to 1998. Most notably, \$12.2 billion in oil sale proceeds were allegedly diverted into extra-budgetary accounts and projects during the 1984-85 price hike. One government committee also found that \$1.5 billion went into "special accounts" in the first six months of 1993. For details, see Nwankwo (op.cit., 2006), p.112.

Clarify when NNPC subsidiaries, including the trading businesses and NPDC, can retain revenues, and audit past subsidiary earnings and operations.

A string of parliamentary probes and audits have accused NNPC of failing to remit billions of dollars in subsidiary earnings to the Federation Account.⁸⁶ In 2012, a presidential task force questioned the “legal basis” and “business justification” for such withholdings “given the poor performance records and unprofitability of many [NNPC] subsidiaries.”⁸⁷

NNPC has a total of 13 subsidiaries and a range of joint ventures, and most show symptoms of this problem. For instance, NNPC manages the federal government’s 49 percent shares in Nigeria LNG Ltd, and receives dividends through this participation worth around \$1.5 billion a year. NEITI has consistently reported that NNPC has failed to transfer the dividends to the Federation Account. This practice stretches back to at least 2006, with over \$10 billion in NLNG dividends cumulatively retained by NNPC.⁸⁸ In July 2015, perhaps signaling a shift in practice, the new Buhari administration secured a portion of these funds for a transfer to Nigeria’s 36 state governments, many of which are facing severe fiscal crises.⁸⁹

Less is known about the earnings of other subsidiaries. Opacity in NNPC operations means that we cannot estimate the value of revenues they retain. We acknowledge that the companies could have commercially legitimate reasons for holding on to at least some of their inflows. But there is inadequate oversight to ensure that this is the case. Given this report’s focus on oil sales, we highlight the serious problems associated with the remittance of oil sale revenues from two types of NNPC entities:

NNPC’s trading subsidiaries. Starting in the 1980s, NNPC set up five offshore subsidiaries to trade crude oil and refined products (figure 7). Three are JVs with major Switzerland-based traders Trafigura and Vitol. (Below, on page 57, we discuss the appropriateness of selling oil to these subsidiaries.) A 2012 presidential task force described the trading subsidiaries as “operational and financial black boxes.”⁹⁰ They do not declare their earnings, much of which appear to be kept in offshore accounts. NNPC likewise has not clearly explained how these subsidiaries account to their parent company or share profits, either with NNPC or Vitol and Trafigura.

Potential revenue losses to the nation could be large: NNPC records show that subsidiary Calson was allocated nearly 9 percent of total 2011 NNPC exports, oil worth \$2.2 billion; its profits for the year are unknown.⁹¹ Also in 2011, subsidiary Duke likely received over \$10 million in “commissions” from its swap deal with PPMC.⁹²

NNPC does not declare the earnings of its trading subsidiaries, much of which appear to be kept in offshore accounts.

86 See e.g., <http://www.nigerianbestforum.com/index.php?topic=33074.0;wap>; http://www.africa-confidential.com/article-preview/id/3149/Hide_and_seek; <http://allafrica.com/stories/201303120272.html>

87 PRSTF Report p.105.

88 NEITI 2012 Oil and Gas Audit Report p.223f.

89 *Business Day*, “Presidential relief package drawn from NLNG dividends, Excess Crude Account intact,” July 7, 2015, available at: <http://businessdayonline.com/2015/07/presidential-relief-package-drawn-from-nlng-dividends-excess-crude-account-intact/#.VaW03PIViko>.

90 PRSTF Report p. 59. There have also been allegations—which we cannot confirm—that individual subsidiaries bought oil at below-market prices, took part in the scandal-ridden UN Oil-for-Food Program in Iraq, and overstated amounts of fuel supplied to NNPC on official documents. Berne Declaration Nigeria Report p.6. According to PwC and NEITI, one cargo that NNPC sold to Calson in 2012 was priced \$430,090 below OSP. PwC Report p.141, NEITI 2012 Oil and Gas Audit Report, Appendix 9.3.4.3A.

91 Ibid.

92 See annex B sec.2.1.

Company (country of incorporation)	NNPC ownership stake	JV partner
Duke Oil Company Inc. (Panama)	100	none
Duke Oil Services Ltd. (UK)	100	none
Calson Ltd. (Bermuda)	51	Vitol
Hyson Ltd. (Nigeria)	60	Vitol
Napoil Company Ltd. (Bermuda)	51	Trafigura

Figure 7. NNPC trading companies

Nigerian Petroleum Development Company (NPDC) Ltd. When NNPC sells oil from blocks owned by NPDC—a reported 80,243 barrels per day in 2013—it does not forward any proceeds to the treasury. The revenues it holds onto are substantial: PwC estimated total earnings from NPDC oil sales at \$6.82 billion over nineteen months in 2012 to 2013.⁹³ It is unclear why NPDC would need such large withholdings: the majority of its blocks are developed under contracts—including the Strategic Alliance Agreements—that require private partners to cover its share of operating costs.

Who collects and controls the revenues from NPDC sales is unclear from available information. NPDC’s own financial statements do not list them,⁹⁴ and the company has no settled practice of paying dividends to NNPC or the treasury.⁹⁵ Instead, NNPC COMD sells the oil for NPDC and proceeds are lodged in an “NPDC/NNPC Special Account” which NNPC controls.⁹⁶ According to NEITI, \$3.975 billion went into the “Special Account” for 2012 oil sales.⁹⁷ The Nigerian Senate Finance Committee concluded that this arrangement “undermines [NPDC’s] status as a separate legal entity and makes proper accounting difficult.”⁹⁸ NNPC has not explained how the funds are spent.

We cannot discern how much money NNPC has received in total from NPDC liftings. Illustrating some of the serious accounting issues, PwC, during its recent audit, received three conflicting sets of NPDC lifting and sales figures, from the Department of Petroleum Resources (DPR), NNPC COMD and the company itself. When reconciling these proved impossible, the auditors accepted total NPDC revenues of \$6.82 billion in nineteen months as “reasonable enough.”⁹⁹

When NNPC sells oil from blocks owned by NPDC, it does not forward any proceeds to the treasury.

93 PwC Report p.85, 87.

94 Office of the Auditor-General of the Federation, “Press Release: Highlights of the Investigative Forensic Audit by PwC,” February 5, 2015, available at: <https://www.oaugf.ng/78-highlights-of-investigative-forensic-audit-done-by-pwc>.

95 PwC Report p.83; NEITI, 2012 Oil and Gas Audit Report p.35.

96 NEITI 2012 Oil and Gas Audit Report p.324, 331. NPDC, like other upstream petroleum companies, is required by statute to pay royalties and PPT on its operations. It pays these in cash.

97 NEITI 2012 Oil and Gas Audit Report, Appendix p.11.1.2, p.938.

98 Nigerian Senate Finance Committee, Report of the Senate Committee on Finance on the Investigation into the Alleged Unremitted \$49.8 Billion Oil Revenues by the Nigerian National Petroleum Corporation (“the Senate Finance Committee Report”), June 2014, p.47.

99 PwC Report p.87. NB: This number could be gross of liftings by private companies under the SAAs, though PwC’s figures are difficult to interpret. Id p.85.

NPDC oil sales come from two main sources, and NNPC appears to retain all the oil sale revenues from both:

- *Okono liftings.* All of Nigeria's Okono grade crude oil comes from the offshore block OML 119. NPDC has held 100 percent equity in this block since the early 2000s; the ENI subsidiary Agip Energy and Natural Resources Nigeria Ltd. (AENR) has operated the block for NPDC under the country's only service contract.¹⁰⁰ OML 119 produced 34,948 barrels per day of Okono grade crude in 2014. NNPC sells the share of this oil that belongs to NPDC. A few private oil traders—recently, Sahara Energy and Taleveras above all—have bought NPDC's share of Okono from NNPC, lifted it and sold it to foreign buyers.¹⁰¹

Our research found no evidence that NNPC forwarded to the treasury any earnings from the more than 110 million barrels of Okono crude it reported selling between 2005 and 2014. Using average annual sale prices, we provisionally estimate that this oil was worth up to \$12.38 billion (figure 8). It is not clear why NNPC, or NPDC, would need to withhold from the treasury such large earnings resulting from the sale of OML 119's output. The original service contract for the block required AENR to cover nearly all operating costs in exchange for receiving a share of production, meaning NPDC/NNPC did not need to contribute funds to keep the oil flowing.¹⁰²

There was likewise no evidence from NNPC reporting to other government agencies that the corporation reports on the proceeds from sales of Okono as revenue due to the Federation Account. For example, the monthly spreadsheets about oil sales that NNPC sends to FAAC do not show Okono liftings or the resulting earnings.¹⁰³ Past NEITI audit reports also did not reconcile revenues or liftings of Okono, or show any remittances of proceeds to the Federation Account.¹⁰⁴ Available records therefore indicate NNPC retained revenues from the sale of 110 million barrels of oil over ten years from one block.

Available records indicate NNPC retained revenues from the sale of 110 million barrels of oil over ten years from one block.

100 Some press reporting said independent company Petrofac, together with Nigerian trader and swap holder Taleveras, won a new contract to replace AENR on OML 119 in 2013. We have not been able to confirm this. See e.g., *Africa Oil and Gas Report*, "Petrofac Clinches Strategic Alliance Partnership for OML 119," August 6, 2013, available at: <http://africaoilgasreport.com/2013/08/farm-in-farm-out/petrofac-clinches-strategic-alliance-partnership-for-oml-119/>.

101 Market intelligence data on file with NRGi.

102 Under the contract, AENR was supposed to provide all funds needed to develop two fields in OML 119, and operate the fields jointly with NPDC. In exchange for this, it could recoup the funds in cost oil and lift either 40 or 70 percent of whatever profit oil was left after payment of taxes and royalties. Service Contract Between NPDC and AENR for the Development of Okono and Okpoho Fields in OPL 91, October 2000, Art.4.1, 6, 10.2.

103 Finding based on review of a sample of NNPC Crude Oil Lifting and Sales Profiles and NNPC monthly presentations to the FAAC Technical Subcommittee for the years 2005 to 2015.

104 NEITI's 2012 Oil and Gas Audit Report did include lifting and sales data for Okono for the limited purpose of reconciling NPDC's tax obligations. NEITI 2012 Oil and Gas Audit Report Appendix 9.

Year	Okono barrels sold by NNPC*	Estimated average price per barrel (\$)!	Estimated total value of sales (\$)
2005	20,140,816	54	1,088
2006	21,170,299	65	1,376
2007	13,097,910	73	956
2008	10,763,075	100	1,076
2009	15,998,979	62	992
2010	15,254,403	79	1,205
2011	15,252,150	111	1,693
2012	15,280,468	112	1,711
2013	12,685,656	110	1,395
2014	12,053,749	74	892
Total	110,386,390	-	12,384

Figure 8. Estimated value of NNPC sales of Okono crude oil, 2005-2014

* Source: NNPC Annual Statistical Bulletins

! Source: For 2005-2013, we used Platts reference prices for Forcados grade crude minus a discount of between \$1 and \$2 per barrel (with rounding to the nearest dollar), to reflect the generally lower monthly OSPs that NNPC COMD sets for Okono vis-à-vis Forcados. 2014 figure is based on analysis of Platts data and NNPC monthly OSP sheets on file with NRGJ.

- Forcados equity liftings from ex-Shell blocks.* Starting in 2010, NNPC assigned its 55 percent equity in eight onshore JV blocks to subsidiary NPDC for a reported \$1.85 billion. It did this around the time that the JV partners Shell, Agip and Total sold their minority stakes in the blocks to smaller companies. NPDC then signed strategic alliance agreements (SAAs) for the eight assets either with Septa Energy Nigeria Ltd., a subsidiary of Seven Energy International, or with Atlantic Energy Drilling Concepts Ltd. (figure 9). Under the SAAs, Septa and Atlantic are supposed to fund NPDC’s 55 percent share of operating costs in exchange for rights to lift parts of the oil produced from the blocks. All of the oil is classified as Forcados grade for export purposes. As with OML 119, because the SAA partner companies cover NPDC’s cash calls for the eight blocks, it is not clear why NNPC would need to withhold billions of dollars in oil sale revenues. NNPC justifies the revenue retention with two reasons: its ceding of equity to NPDC—which it describes like a sale to a private company, even though NPDC is a publicly owned entity—and government’s failure to fund NPDC’s operations.¹⁰⁵

Block(s)	Minority JV shareholders	SAA partner
OML 4, 38, 41	Seplat	Septa
OML 26	First Hydrocarbon Nigeria and Afren	Atlantic
OML 42	Neconde and Kulczyk Oil	Atlantic
OML 30	Shoreline and Heritage Oil	Atlantic
OML 40	Elcrest and Eland Oil & Gas	Atlantic
OML 34	Niger Delta Western and Petrolin	Atlantic

Figure 9. NPDC blocks with SAAs

In addition to the revenues withheld from the eight blocks listed above, by some

¹⁰⁵ More specifically, NNPC told NEITI that “NNPC divested its interest in the NNPC/SPDC JV in OMLs 26, 30, 34, 40, and 42 to the NPDC in year 2011. The Divestment was consented to by the HMPR pursuant to the rights of the HMPR prescribed in the Petroleum Act. The Deed of assignment of the divested assets assigned 55% equity interest in addition to right of operatorship to NPDC. The Good and valuable Consideration has been determined by the DPR and NPDC has made part payment. The proceeds from these lifting therefore belong wholly to NPDC and not to the Federation account. [...]The Federation no longer pays cash call for NPDC operations for the divested assets. Therefore, NPDC lifting proceeds are not subject to remittance to the Federation Account.” NEITI 2012 audit report p.330. See also NNPC Response to Sanusi, p.8.

accounts, the SAAs themselves may be a major source of revenue loss for the Nigerian state. Trade press reporting, audit work and former CBN governor Sanusi variously have claimed that:

- The contracts were awarded outside constitutional and statutory procedures to politically connected companies.¹⁰⁶
- The SAAs with Atlantic cast NPDC as the fields' operator, despite the company lacking the technical wherewithal to play this role.¹⁰⁷
- NNPC valued its share in the assets at \$1.85 billion, and used this figure in its sale of the assets to NPDC. But PwC, in its 2014 audit, estimated the total value of the blocks at around \$3.4 billion. NPDC also paid only \$100 million of the \$1.85 billion.¹⁰⁸
- The SAAs—the Atlantic SAAs in particular—have underperformed, delaying development of at least some of the eight blocks. In particular, media outlets have reported that the partner has not provided enough funds to cover NPDC's cash calls and has lifted more oil than the terms of the contracts allowed.¹⁰⁹
- Record-keeping and reporting for the SAA blocks was substandard. In its 2012 audit, for instance, NEITI could not reconcile conflicting sets of production, terminal receipts and lifting figures from NNPC, Shell (operator of the Forcados terminal, where most NPDC crude is exported), and DPR.¹¹⁰

We have been unable to independently verify these allegations. Septa and Atlantic have publicly denied these and other claims.¹¹¹ Nonetheless, the rumors of mismanagement are so pervasive and serious that the government should set the record straight and address any problems. We therefore recommend that the presidency commission a performance audit of the SAAs, to run in conjunction with a larger audit of NNPC subsidiaries' earnings and operations, that would require full submissions from NNPC, NPDC, Septa, Atlantic and Shell, which lifted and marketed some SAA crude from the eight blocks.¹¹²

The rumors that the SAAs are mismanaged are so pervasive and serious that the government should set the record straight and address any problems.

106 Sanusi Senate Submission presentation p.10; *Reuters*, "Nigerian lawmakers to probe state oil firm deals without tenders," May 3, 2013, available at: <http://www.reuters.com/article/2013/05/03/nigeria-oil-idUSL6N0DK3GU20130503>

107 Sanusi Senate presentation p.11; *Africa Oil and Gas Report*, "Looking Beyond the Diezani Tenure," January 29, 2015, available at: <http://africaoilgasreport.com/2015/01/kickstarter/looking-beyond-the-diezani-tenure/>.

108 PwC Report p.82.

109 *Petroleum Intelligence Weekly*, "Is Indigenization Delivering for Nigerian Firms?" July 16, 2015; *Daily Trust*, "How NNPC May Lose \$2Bn in Controversial Agreement," May 21, 2015, available at: <http://dailytrust.com.ng/daily/index.php/top-stories/55289-how-nnpc-may-lose-2bn-in-controversial-agreement>; *The Nation*, "Revealed: How Nigeria Lost \$2bn in Oil Deals," July 21, 2015, available at: <http://thenationonlineng.net/revealed-how-nigeria-lost-2b-in-oil-deals/>; *The Nation*, "Inside the Oil Deals That Cost Nigeria Billions," July 21, 2015, available at: <http://thenationonlineng.net/inside-the-oil-deals-that-cost-nigeria-billions>.

110 NEITI, 2012 Oil and Gas Audit Report, p.332.

111 See e.g., <http://www.sevenenergy.com/media/news-and-announcements/2013/10-05-2013>; <http://www.sevenenergy.com/media/news-and-announcements/2011/15-06-2011>; <http://www.sevenenergy.com/media/news-and-announcements/2015/11-02-2014>; <http://www.atlanticenergy.com/frequently-asked-questions-regarding-atlantic-energys-business-model-2/>; <http://www.atlanticenergy.com/indigenous-partnership-of-oil-assets-increases-npdc-production-3/>; <http://www.atlanticenergy.com/legality-of-nnpcs-alliance-agreements/>

112 Market intelligence data on file with NRGi.

<div style="display: flex; align-items: center;"> <div style="background-color: #e67e22; border-radius: 50%; width: 40px; height: 40px; display: flex; align-items: center; justify-content: center; margin-right: 10px;"> issue 3 </div> <div style="background-color: #2c4e64; color: white; padding: 5px 15px; font-weight: bold;">Oil-for-product swap agreements</div> </div>	
Problems	<ul style="list-style-type: none"> • NNPC channeled oil worth \$35 billion to swap deals between 2010 and 2014. • In 2015, nearly 20 percent of the oil sold by NNPC has been traded for petroleum products via poorly structured deals with two companies. • Recent offshore processing agreements (OPAs) contained unbalanced terms that did not efficiently serve Nigeria’s needs. We estimate that losses from three provisions in a single contract could have reached \$381 million in one year (or \$16.09 per barrel of oil). • Swap imports are vulnerable to downstream rackets around Nigerian fuel transportation, distribution and sales.
Recommendation	<p>The government should direct NNPC to wind down all OPAs and should not sign any more such deals. Future swaps should be competitively awarded refined product exchange agreements (RPEAs) with stronger terms.</p>

Motivated by the threat of fuel shortages and staggering debts to fuel importers, the Jonathan government began using swaps in 2010 and 2011.¹¹³ Since then, NNPC has used two types of swaps:

- Under a **refined products exchange agreement (RPEA)**, crude is allocated to a trader, and the trader is then responsible for importing specified products worth the same amount of money as the crude, minus certain agreed fees and expenses the value of which the trader keeps.
- Under an **offshore processing agreement (OPA)**, the contract holder—either a refiner or trading company—is supposed to lift a certain amount of crude, refine it abroad, and deliver the resulting products back to NNPC. The contracts lay out the expected product yield (i.e. the respective amounts of diesel, kerosene, gasoline, etc.) that the refinery will produce. The company also can pay cash to NNPC for any products that Nigeria does not need.

We estimate the value of the oil allocated to swaps from 2010 to 2014 at \$35 billion.

Seven swaps have been signed since 2010; management of some has been subcontracted out to Nigerian trading companies (figure 10).¹¹⁴ We estimate the value of the oil allocated to the swaps over the period of 2010 to 2014 at approximately \$35.0 billion.

113 By 2010, the refineries were working at only around 20 percent of capacity and PPMC had racked up over \$3 billion in cash debts to fuel traders that it could not pay. Some of the bills were around three years overdue.

114 Several swap contracts, including the three discussed here, are available at www.resourcegovernance.org/publications/inside-NNPC-oil-sales.

No.	Party	Oil allocation (barrels per day)	Duration
Refined Product Exchange Agreements (RPEAs)			
1.	Trafigura Beheer BV	60,000	2010-2014
2.	Duke Oil (Panama) Ltd., which entered into subcontracts with several companies who managed 30,000 barrels per day apiece:	90,000	2011-2014
2.a	→ Taleveras Petroleum Trading BV	→ 30,000	2011-2014
2.b	→ Aiteo Energy Resources Ltd.	→ 30,000	2011-2014
2.c	→ Ontario Trading SA	→ 30,000	2011-2014
3.	Duke Oil (Panama) Ltd., which subcontracted to:	30,000	2015-2016
3.a	→ Aiteo Energy Resources Ltd.	→ 30,000	2015-?
Offshore Processing Agreements (OPAs)			
1.	Nigermed Ltd., a fuel marketing joint venture between NNPC and British Petroleum (BP)	60,000	2010
2.	Société Ivoirienne de Raffinage (SIR), which entered into a subcontract to manage the full amount with:	60,000	2010-2014
2.a	→ Sahara Energy Resources Ltd.	→ 60,000	2010-2014
3.	Sahara Energy Resources Ltd.	90,000	2015-2016
4.	Aiteo Energy Resources Ltd.	90,000	2015-2016

Figure 10: RPEA and OPA holders, 2010-present

These deals have helped NNPC keep gasoline and kerosene flowing into the country since it became unable to pay cash for fuel. But they have also absorbed huge amounts of the crude that Nigeria has to sell—around 210,000 barrels per day since 2011, roughly a tenth of total production and a fifth of all NNPC sales. NNPC and the contract holders have run these deals with limited transparency and oversight. The swaps also come with inherently high governance risks, have a history of controversy and are widely seen as costly to Nigeria. Some contract winners lacked fundamental trading capabilities—the abilities to market their own crude and source their own products directly from refiners, for instance. There are persistent, unanswered questions about whether all have supplied enough products. The contracts, particularly the OPAs, contain provisions that lower the returns for Nigeria, as well as underspecified terms and undue complexity. They were not operated in accordance with their design, and failed to target the supply of the products needed most by Nigeria. Periodic reconciliation meetings, held between the parties to the deal, were the only checks and balances in place to ensure the traders met their delivery obligations. We look at all of these points in depth in annex B.

Following a two-track reform plan is especially important in this area. Right now, the government must ensure steady supplies of fuel. To do that, NNPC will need to rely on swaps until it solves its refining woes or it has the cash or credit to buy imported fuel.¹¹⁵ The recommendations in this section respond to this short-term reality. But eventually, Nigeria will need to fix the deeper problems in its downstream sector. The only sustainable way forward we see is for government to sell NNPC’s downstream businesses, including the refineries, and totally remove the corporation as a player

¹¹⁵ Traders and bankers interviewed for this report thought that no bank would finance more PPMC cash imports, as the company still owes roughly \$1.5 billion in overdue debts to traders, and that the refineries and private marketers with PPPRA import permits cannot supply 100 percent of the country’s needs in the current environment. Interviews, 2013-15.

in the local fuel market. Nigeria should also eliminate the fuel subsidy that has bred dysfunction and bled public funds, and prevent swaps from becoming a permanent feature of its energy landscape. Only by taking these steps, which are discussed further on pages 67-69, can the country avoid the kinds of costly, underperforming deals described here.

Abandon OPAs; Restructure the RPEAs to deliver better returns.

The government should seek to close out the two current OPAs with Sahara and Aiteo as soon as possible and refrain from signing more. An OPA's higher complexity makes it more opaque than an RPEA—and more prone to abuse. Whether Nigeria loses value is based on a high number of technical factors that few officials can effectively negotiate or monitor. Our analysis of the 2010 PPMC-SIR OPA and the 2015 Aiteo OPA found more points of possible government revenue loss than we found in the RPEAs (see box 1). We cannot confirm that the deals did in fact cost Nigeria more than the RPEAs—only a full audit could do that—but our analysis indicates that the *potential* for loss was inherently greater.

Along with their undue complexity, OPAs do not meet Nigeria's actual fuel needs efficiently. They supply a wide slate of products when NNPC only needs gasoline and kerosene. The main reasons for choosing an OPA—offloading hard-to-sell-crude, hedging against volatile commodity prices—may somewhat better reflect Nigeria's situation today than when the PPMC-SIR deal was signed. But overall, the risks of ending up with an unaccountable, unpoliceable, costly deal are simply too high.

Along with their undue complexity, OPAs do not meet Nigeria's actual fuel needs efficiently.

If structured and carried out with balance and integrity, RPEAs could be more a sensible temporary option for Nigeria. A trader's obligations under an RPEA turn on a price-for-price valuation system that is much simpler to evaluate, manage and monitor. The parties can more easily limit the products supplied to those that Nigeria needs. The 2011 contract signed with Duke Oil could be an acceptable model for future deals, assuming that NNPC:

- Awards agreements competitively and transparently to companies, whether Nigerian or foreign, with top-notch financial and operational credentials.
- Revises the pricing provisions in the contract by 1) using regular NNPC OSPs to price all crude oil lifted, 2) reviewing the cost structures behind pricing premiums for gasoline and kerosene, and 3) exploring options for adjusting the pricing premiums more regularly for seasonal and other changes in the market.
- Clarifies some terms in the contract, currently left too open to interpretation, especially those governing which documents to use for pricing products and recording volumes delivered, calculating demurrage payments and fixing fuel delivery due dates.

Box 1: Problems with the 2010 SIR OPA and the 2015 Aiteo OPA

The OPAs signed with Ivorian refiner SIR in 2010 and Nigerian trader Aiteo in late 2014 were not efficient choices for Nigeria, and are prime examples of why the country should not sign more OPAs. The contracts contained high numbers of unbalanced or inadequately defined terms that did not offer NNPC-PPMC fair value for their oil. Under the 60,000 barrels per day SIR contract, which Nigerian trader Sahara managed for SIR:

- PPMC allowed Sahara to lift lighter grades of crude oil which under the contract's weight-based calculation system gave PPMC fewer products in exchange for each barrel of crude lifted. The grades Sahara lifted also allowed it to satisfy more of its delivery obligations with cheaper types of refined fuel that Nigeria did not need—especially fuel oil and vacuum gasoil.¹¹⁶
- PPMC gave SIR an allowance for oil lost in the refining process that was significantly higher than SIR's own reported averages, again lowering the amount of products imported.
- Sahara was also permitted to meet its weight obligations by supplying heavier gasoline and kerosene. This gave PPMC fewer liters to sell on to consumers.
- Other critical processes were not clearly defined—for instance, the provisions for substituting diesel imports for gasoline and kerosene.¹¹⁷

We conservatively estimate that the first three of these factors, taken together, could have cost PPMC and Nigeria \$381 million (or \$16.09 per barrel) in 2011, the contract's first full year of operation.¹¹⁸ Using calculations based on the contract terms, third party price data and the 23.6 million barrels of crude that Sahara lifted under the OPA in 2011, we estimate that losses could have reached: \$8.17 per barrel, from the unfavorable yield patterns for the specific grades of crude that NNPC sold most often under the OPA; \$2.96 per barrel, from the high allowance for refining fuel and loss (RF&L); and, \$4.96 per barrel, because the contract allowed Sahara to import heavier products that gave PPMC lower volumes of fuel to sell.

Furthermore, the deal's main premise was that SIR would itself refine the crude. But according to interviews and documents related to the deal, PPMC and Sahara bypassed SIR's Abidjan refinery altogether and ran the deal like an RPEA, selling crude and buying products from the global market. But, Sahara's product obligations were still calculated as though SIR was actually refining the crude. This practice made the deal's inner workings even more opaque.

The 2015 Aiteo OPA, for 90,000 barrels per day, inherited most of these problems. While it did not name a specific refinery for processing the oil, the contract contained yield patterns that were even more unfavorable to NNPC than those in the SIR contract. While examining shipments of crude and fuel under the deal, we found no evidence that Aiteo delivered the oil to a refinery. Instead, other companies—mainly Shell—lifted and marketed the oil and Aiteo purchased fuel from overseas gasoline blenders for delivery to NNPC.

We wrote to SIR, Sahara, Aiteo, PPMC and NNPC with detailed questions on how the SIR and Aiteo OPAs were structured and managed. SIR, PPMC and NNPC did not reply. Sahara responded and directed us to press releases on its website about the OPA.¹¹⁹ Aiteo asked us to sign a non-disclosure agreement before it could respond; we declined, and they did not respond further.

¹¹⁶ Sahara justifies this process by saying it was agreed "following detailed commercial negotiations which took into account a large number of factors including the value on the international market of the different grades of crude oil that could be made available by PPMC, the yields that could be achieved from refining those grades of crude oil at various refineries as well as the yield that is achievable by SIR, the cost of the refining process and the cost of transportation to and from the refinery." <http://www.sahara-group.com/cg/opa-explanation.pdf>. For our reaction to this explanation, see annex B p.B29.

¹¹⁷ Sahara in its press release on the OPA said that it substituted products under the deal "for the convenience and benefit of the Nigerian public" and that "the parties apply contractually defined OPA conversion formulae to determine the exact volume of 'Substitute Products' to be delivered for the particular grade of crude oil that has been supplied." Ibid. However, our analysis of the contract found no detailed formulas or other descriptions of how the process should work. See annex B p.B34.

¹¹⁸ Pages B27 to B31 in annex B detail how we reached this calculation.

¹¹⁹ Ibid.

Explore options for breaking the various rackets around NNPC fuel imports.

Traders with NNPC-PPMC swap contracts deliver refined products into the existing supply chain for NNPC fuel imports—a complex, hard-to-track array of moving ships, tanker trucks, pipeline deliveries, third-party service providers and opaque, multi-step sales. As the 2012 fuel subsidy scandal showed—and as annex B explains more fully (see section 4)—the complexity of the supply chain exists partly to serve a number of entrenched, lucrative rackets around shipping, distribution and sales of fuel. These include smuggling, selling locally refined products back to NNPC at import prices, overcharging for deliveries, and outright theft.¹²⁰

The 2012 fuel subsidy investigations focused mainly on mismanaged imports by private companies, but we find that NNPC imports carry many similar risks. While the problems with the NNPC fuel supply chain are bigger than the swaps, the product imports associated with the swaps would be as susceptible as any to these broader shortcomings, and our research found some evidence of contract holders engaging in bad practices. (See annex B.) Looking ahead, unless the executive can clean up the worst rackets around fuel imports and improve oversight, swaps will hemorrhage considerable amounts of fuel and money no matter how they are structured. Further study will determine which steps would bring better results, though we list some steps the new government could take in annex B.

<div style="display: flex; align-items: center;"> <div style="background-color: #e67e22; border-radius: 50%; width: 40px; height: 40px; display: flex; align-items: center; justify-content: center; margin-right: 10px;"> 4 </div> <div> <p style="margin: 0;">issue</p> <p style="margin: 0;">The abundance of middlemen</p> </div> </div>	
Problems	<ul style="list-style-type: none"> • Nigeria is the only major, stable world oil producer that sells crude mostly to traders rather than end-users. • NNPC enters into term contracts with unqualified intermediaries that capture margins for themselves and create reputational risks for legitimate market players while adding little or no value to deals. • NNPC also sells to governments that do not refine the crude they buy. These deals have featured a glut of unnecessary middlemen, and prompted corruption scandals in five buyer countries.
Recommendation	<p>NNPC should stop selling oil to unqualified companies, whether Nigerian or foreign, and improve its due diligence standards.</p>

Nigerian crude sales are especially confounding and complex in the area of buyer-seller relationships. “Nigeria is a minefield,” said one experienced analyst who tracks the market. “It’s almost impossible to work out who’s selling for whom.”¹²¹ Much of the complexity is sanctioned by NNPC and seems designed to serve the narrow interests of well-connected politicians and powerbrokers who derive benefits from the system in exchange for doing very little.

120 For more info, see e.g., Morillon, Virginie, and Servais Afouda, “Le trafic illicite des produits pétroliers entre le Bénin et Nigeria,” Economie Régionale (LARES), 2005; Nigerian House of Representatives, Report of the Ad-Hoc Committee To Verify and Determine the Actual Subsidy Requirements and Monitor the Implementation of the Subsidy Regime in Nigeria (Farouk Lawan, chair) (“the Lawan Report”), April 2012, p.11

121 Correspondence with authors, 2013.

NNPC markets Nigeria's crude to a wider range and number of buyers than most large NOCs. Most years, COMD signs term contracts with:

- *Large international oil traders.* The largest buyers of NNPC crude in this class have been Vitol, Glencore, Trafigura, Arcadia, Mercuria, Addax and Gunvor – all Switzerland-based trading houses.
- *Experienced Nigerian trading companies.* These companies have the technical and financial capabilities needed to market, finance, lift and transport oil to buyers around the world. Their market share has grown considerably. Sahara and Taleveras have been the largest players in this group since President Jonathan took office in 2010.
- *Foreign refineries.* Each year's term contract winners include a few foreign refineries, though these do not always process the crude they receive.¹²²
- *NNPC oil trading companies.* COMD also sells oil on a term basis to NNPC's trading-focused subsidiaries.
- *Government-to-government (g-to-g), or "bilateral" customers.* Since the 1970s, NNPC has regularly sold oil to other countries, above all three of the BRICs, a few West African refiners, and other, smaller countries, most of them African, which do not have refineries.
- *Briefcase companies.* In the language of the Nigerian crude oil market, a "briefcase company" is a small entity that routinely re-sells the cargoes it get to another intermediary—for example, a larger, more experienced commodities trading firm, which then re-sells the cargo to a third party buyer.

As this list shows, nearly all NNPC term contract holders have one thing in common: they are intermediaries. They buy oil from NNPC and then sell it to other companies instead of refining it themselves. Nigeria is the only major world oil producer (i.e., producing more than one million barrels per day) not experiencing full-scale conflict that sells almost all of its crude to middlemen, rather than end-users.¹²³ Other non-conflict countries do also favor traders—including some in sub-Saharan Africa—but they are typically small or new producers, short of credit or facing severe instability.

The simplest transactions involve COMD selling a cargo to a trader with a term contract. The trader then re-sells to a buyer in the global market—for example, another trader, or a refining or oil storage company—keeping the margin between the price it agreed with NNPC and what it obtained from the buyer.

Nearly all NNPC term contract holders buy oil from NNPC and then sell it to other companies instead of refining it themselves.

NNPC → trader → global market

122 For example, the Fujairah refinery, which Vitol subsidiary Vitol Tank Terminals International (VTTI) runs, has won several NNPC term contracts. But Fujairah is not well configured to process Nigerian crude, and so another Vitol subsidiary sells its cargoes in the spot market. Finding based on a comparison of NNPC oil sales records and market data on file with NRG, confirmed by author interviews with traders and industry consultants, 2010 and 2014.

123 PRSTF Report p.75-6.

In other cases, COMD sells to a less capable intermediary—a briefcase company, for instance—which then re-sells to a trading house that has the financial and operational wherewithal to actually lift and sell the crude. A foreign refinery then buys from the trader, meaning the oil changes hands at least three times:

NNPC → briefcase company → trader → global market

Under this system, NNPC term contract holders can earn significant margins while adding little or no value to NNPC, which could have sold directly to the later buyers. Many have no industry track record when they sign their first contracts. A 2012 Nigerian government task force noted that many of NNPC’s term customers “did not demonstrate renowned expertise in the business of crude oil trading” and had “little or no commercial and financial capacity.”¹²⁴ Two years earlier, KPMG warned that some of Nigeria’s oil “might be sold to non-credible off-takers.”¹²⁵ As part of our research, we performed Nigerian corporate record checks on 16 of the 2014-2015 term contract winners.¹²⁶ These findings are available on the NRGI website.

A-Z Petroleum	Dans Global Engineering	Hyde Energy	Sinopec Oil Corporation
Addax Energy SA	Delaney Petroleum Corp.	Ibeto Petrochemical Industries	Somol Sociedade Petrolifera Angola SA
Aiteo Energy Resources	DK Global Energy Resources	Indian Oil Corporation	Sonar Tusk Ltd.
AMG Petro Energy	Duke Oil	Mercuria Energy Trading SA	Springfield Ashburton
Avidor Oil and Gas Company	Effective Energy	Mezcor SA	Sullum Voe
Azenith Energy Resources	Elan Oil and Gas	Northwest Petroleum and Gas Company	Taleveras
Barbedos Oil & Gas Services	Elektron Petroleum Energy and Mining	Ontario Trading SA	Team Trade International
Bono Energy	Emo Oil and Gas Petrochemical Company	Petrovietnam	Tempo Energy SA
Calson	Eterna Plc.	PTT Public Company	Tevier Petroleum
Century Energy Services	Fujairah Refinery	Republic of Malawi	Tridax Energy SA
Crudex International		Sahara Energy Resources	Voyage Oil & Gas Ltd.

Figure 11. Reported 2014-2015 NNPC term contract holders

Source: Reuters¹²³

124 Id. p.15.

125 KPMG Project Anchor Report sec.3.4.8.

126 CAC search reports available at www.resourcegovernance.org/publications/inside-NNPC-oil-sales.

127 Reuters, “TABLE: Nigeria’s expanded list of oil contract winners,” June 5, 2014, available at: <http://in.reuters.com/article/2014/06/05/nigeria-oil-sales-idINL6N0OK42O20140605>.

NNPC's habit of selling Nigeria's oil to intermediaries, especially those with few qualifications, looks more politically motivated than commercially driven. The main costs and risks to Nigeria are:

- *Payments to PEPs.* Some NNPC crude oil sales involve payments to Nigerian, and sometimes foreign, political elites, including government officials. By the late military period of the 1990s, NNPC's term lifting contracts became a form of patronage. They rewarded power brokers and served as vehicles for self-enrichment and building campaign war chests.¹²⁸ One 2013 study noted: "Selling to briefcase [companies] attracts many shadowy political handlers and 'politically exposed persons.' [...] A typical briefcase company is owned by one or more private individuals acting as a 'front' for top political office-holders and power-brokers. The briefcase then splits the margins it receives with the official."¹²⁹

Yet while few buyers would admit openly to paying officials at NNPC or elsewhere in government,¹³⁰ some say privately that payments remain a basic part of the business,¹³¹ echoing the finding of a 1999 Human Rights Watch assessment that "getting a share of the trade is dependent on political patronage."¹³² The payments can occur through different channels, according to past cases and experienced industry players. Companies often pay an official or a well-connected individual (often called their "sponsor") in exchange for receiving the allocation of crude. This kind of facilitation or "thank you" payment does not in itself suggest that the sponsor is a hidden owner of the paying company, interviewees said.¹³³ In such cases, the trader that ultimately lifts the crude may prefer to buy the oil from a middleman that can more easily make such payments, thereby giving more deniability and distance to the ultimate buyer. In other cases, the PEP holds an interest in the trading company itself, and will profit from its activities. Officials' names rarely show up on the records that NNPC term contract holders file with Nigeria's Corporate Affairs Commission (CAC). Instead, PEPs tend to hold their beneficial ownership interests indirectly—for instance, through nominee shareholders, family members or secret agreements with "fronts."¹³⁴

By the late military period of the 1990s, NNPC's term lifting contracts became a form of patronage. They rewarded power brokers and served as vehicles for self-enrichment and building campaign war chests.

Politically exposed persons tend to hold their beneficial ownership interests indirectly—for instance, through nominee shareholders, family members or secret agreements with "fronts."

128 See annex C p.14 (discussing the case of Trafigura in Jamaica); see also *Petroleum Intelligence Weekly* (PIW), "Nigeria Feels Squeeze from Light Crude Glut," July 21, 2014; PIW, "Politics Helps Explain Nigeria's Cut-Price Crude," July 28, 2014.

129 Christina Katsouris and Aaron Sayne, *Nigeria's Criminal Crude: International Options for Combatting the Export of Stolen Oil* ("the Katsouris and Sayne Oil Theft Report"), Chatham House Programme Report, September 2013, p.8, available at: <http://www.chathamhouse.org/publications/papers/view/194254>.

130 In one older example, the now-deceased commodities trading mogul Marc Rich reportedly admitted paying \$1 million dollar to a former Nigerian minister to win a contract. For more detail, see A.C. Copetas, *Metal Men: Marc Rich and the 10 Billion Dollar Scam*, Harper Perennial, 1985.

131 Author interviews, trading company personnel, IOC staff, bankers, government officials and industry consultants, 2010-2015.

132 Human Rights Watch (HRW), *The Price of Oil*, January 1999, p.46, available at: <http://www.hrw.org/reports/1999/nigeria/>.

133 Author interviews, trading company personnel and industry consultants, 2013-14. For more on the topic of beneficial ownership in the extractive industries, see NRGi, *Owning Up: Options for Disclosing Beneficial Ownership of Extractives Companies*, briefing, forthcoming 2015.

134 Author interviews, trading company personnel and Nigerian banker, 2012-2014.

How buyers of NNPC crude with PEPs as hidden owners or sponsors pay these PEPs is not well documented. But industry players and law enforcement personnel consulted for this report laid out several options, based on their own experiences managing and investigating deals. Some companies, the sources said, transfer dividends or consulting fees to proxies for the PEP.¹³⁵ Some pay PEPs' expenses—airfare, hotel bills and shopping trips, for instance—with cash or credit cards.¹³⁶ Luxury items such as cars or private jets might be obtained for the PEP.¹³⁷ Others deliver bulk cash to the PEP's financial intermediaries and then book it as business overhead.¹³⁸ A few preferentially hire politicians' family members or associates.¹³⁹ In more elaborate cases, the interviewees claimed, a briefcase company will be one in a network of companies, both Nigerian and foreign, that invest—or simply hide—funds that an official captured while in office.¹⁴⁰

- *Reputational risks and costs.* The prevalence of politically connected briefcase companies contributes to the perception that Nigeria's petroleum sector is pervasively corrupt, frightening off some investors.¹⁴¹ This can make it more difficult for legitimate oil companies operating in the country—whether in trading or elsewhere—to access finance, and increases the risks of prosecutions for financial crimes.¹⁴²
- *Tax avoidance.* According to interviewees, some NNPC term contract holders sell their cargoes at losses to intermediary companies (in which they have any ownership interest) that are located in offshore jurisdictions. These companies then use the intermediaries to re-sell the oil at profits. This, the interviewees said, allows the contract holders to show losses on their Nigerian books and thereby avoid payment of corporate income tax. We cannot estimate how much the country loses to this practice.¹⁴³
- *Cover for oil theft.* Counterintuitively, criminal actors can benefit from the opacity and complexity of legal NNPC oil sales. In particular, the corporation's practice of selling crude to middlemen creates a confusing, high-risk marketplace that offers cover for stolen barrels to reach oil markets.¹⁴⁴

The prevalence of politically connected briefcase companies contributes to the perception that Nigeria's petroleum sector is pervasively corrupt, frightening off some investors.

135 For an example, see annex C pC15 (discussing the case of Sarb Energy).

136 Author interviews, trading company personnel and law enforcement personnel, 2014-2015.

137 Id., 2011, 2014-2015.

138 Author interviews, trading company personnel and industry consultants, 2012-2015.

139 Author interviews, trading company personnel, IOC staff and industry consultants, 2012-2014.

140 Author interviews, trading company personnel, IOC staff, industry consultants, government officials and bankers, 2012-15. Leading international, political risk and trade periodicals reported for instance, that term contracts under Abacha were negotiated directly out of the Presidential Villa in Abuja and required payments of 10-15 percent "commissions" to political insiders and Abacha family fronts via networks of shell companies and bank accounts in Singapore, Bermuda and Switzerland. See e.g., *Washington Post*, "Corruption Flourished in Abacha's Regime, June 9, 1998, available at: <http://www.washingtonpost.com/wp-srv/inatl/longterm/nigeria/stories/corrupt060998.htm>DATE; *Africa Confidential*, issues of May 1, 1998, June 26, 1998, April 16, 1999, May 14, 1999; Jędrzej Frynas, *Oil in Nigeria*, LIT Verlag Münster, 2000, p.40.

141 We spoke with a number of bank and oil company personnel who stated that they had decided not to do business in the Nigerian oil trading market, or related parts of the value chain, due either to general perceptions of the high corruption risks involved, or to due diligence investigations they had undertaken on potential partners. Author interviews, 2011-2015.

142 Author interviews, traders, bankers, investment fund managers, IOC staff, industry consultants, 2011-2015.

143 Author interviews, traders and Nigerian bankers, 2013-2015.

144 *Reuters*, "Buyer beware of \$10 million discounts on Nigerian oil," June 27, 2012, available at: <http://www.reuters.com/article/2012/06/27/us-nigeria-oil-fraud-idUSBRE85Q0T020120627>;" Katsouris and Sayne Oil Theft Report p.12.

- *Lower prices.* Perhaps the most difficult question to answer is how sales to middlemen affect the prices NNPC obtains for Nigeria’s crude. One study put average briefcase company earnings “at the higher end of \$0.25-\$0.40 per barrel.”¹⁴⁵ These amounts are technically margins that could have been captured by the Nigerian state. (See p.58 for more on this.)

It is difficult to see what value, if any, briefcase companies bring NNPC. They typically cannot lift and pay for oil themselves. One 2013 study noted: “Of the fifty term customers for 2012, perhaps only a dozen to twenty have the capacity or will to finance, ship and sell their own cargoes.”¹⁴⁶ Yet as COMD’s yearly lists of contract winners lengthened—from 16 in 1999 to a peak of 57 in 2011—briefcase companies have taken most of the added slots.

It is difficult to see what value, if any, briefcase companies bring NNPC.

Separating the briefcase companies from the capable buyers is not always easy, especially in the current context. Up until the mid-2000s, most Nigerian companies with NNPC term contracts did very little. They often lacked offices or full-time staff. Rather than lift or market any oil themselves, they would sign management contracts with a big trader, under which the trader financed, lifted and sold whatever oil the briefcase company got from NNPC, in exchange for fixed per-barrel commissions. This promised the briefcase company payment no matter how the trader fared.¹⁴⁷

Today, however, the more sophisticated, larger Nigerian term contract holders have busy offices and staff, sometimes based in multiple countries. They arrange their own letters of credit from banks and sell to more than one buyer. A few even have their own trading desks and occasionally sell cargoes FOB straight to overseas refiners. Their importance as NNPC customers has risen: as shown in figure 12, the volumes lifted by Nigerian traders of this type have increased from negligible in 2001 to around 500,000 barrels per day in recent years—around half of the oil NNPC had to sell. Two firms—Sahara Energy and Taleveras—have in particular come to rival the international traders in profile and market share, especially under President Jonathan. At the same time, though, most of the other Nigerian firms with industry name recognition today still depend on larger traders, or the trading desks of IOCs, to lift and market their oil abroad (figure 12).

145 Katsouris and Sayne Oil Theft Report p.8. Demands of up to \$0.60/barrel were reported in 2012. Energy Intelligence Briefing, “West African Market Subdued Amid Plentiful Supply of Light, Sweet Crude,” July 17, 2012. These numbers are significantly higher than earlier averages. For example, the Economist Intelligence Unit reported \$0.12-17/bbl in 1999. Economist Intelligence Unit, Nigeria: October 22, 1999, available at: <http://country.eiu.com/article.aspx?articleid=34127603>.

146 Katsouris and Sayne Oil Theft Report p.8.

147 Author interviews, trading company personnel and industry consultants, 2011-14. Some were merely the local arms of the big Nigerian or foreign traders. Others named themselves after larger foreign companies but are unconnected—a practice that continues today.

	June 2001	June 2011	June 2014
Foreign traders	Thousand barrels per day		
Vitol	253	265	190
Glencore	222	32	169
Arcadia	190	32	0
Trafigura	158	130	63
Addax	93	0	0
Itochu	63	0	0
Attock	63	0	0
TOTAL	1013	500	423
Nigerian traders	Thousand barrels per day		
Duke	64*	0	63*
Sahara	0	317	158
Taleveras	0	160	95
Oando	0	32*	0
Ontario	0	32#	32#
Aiteo	0	32#	95!
TOTAL	64	570	442

* = lifted by one or more foreign traders # = lifted by unknown trader ! = lifted by Shell

Figure 12: Lifters of NNPC crude at three points in time, 2001-2014

Source: NNPC documents; market intelligence data on file with NRG.

Even though there now exists a sliding scale between established, operational Nigerian traders and pure briefcase entities, many companies named on NNPC’s term contract lists do not meet COMD’s own award criteria. For 2013, these included a \$500 million minimum annual turnover, a prior track record in trading or “Nigerian oil and gas,” submission of three years of audited accounts, and a commitment to investing in “priority” sectors of the Nigerian economy.¹⁴⁸ Some in the industry defend the award of contracts to such entities, arguing that NNPC must sell oil to less-seasoned Nigerian players in order to boost homegrown trading skills and grow “local content” in the Nigerian crude trading business.¹⁴⁹ While attractive in principle, these ideas should not be used as a smokescreen for sales to politically connected briefcase companies which do little to boost indigenization, market growth or local empowerment but instead redistribute wealth from everyday citizens to elites.

Local content should not be used as a smokescreen for sales to politically connected briefcase companies that lack sufficient qualifications.

148 <http://nnpcgroup.com/Portals/0/NNPC%20Crude%20Application%20Advert%202013%20Revised%20May.pdf>

149 *This Day*, “Alison-Madueke Defends Award of 60 Pcent of Oil Contracts to Local Firms,” April 28, 2014, reprinted at: <http://www.ncdmb.gov.ng/index.php/news-update/100-alison-madueke-defends-award-of-60-of-oil-contracts-to-local-firms>. Section 3(1) of the 2010 Nigerian Oil and Gas Industry Content Development Act requires that “Nigerian independent operators shall be given first consideration in the award of [...] oil lifting licences [...] subject to the fulfilment of such conditions as may be specified by the [Petroleum] Minister.”

To address the costs and risks associated with sales to inappropriate middlemen, NNPC should:

Award term contracts through open, competitive tenders using performance-based criteria.

NNPC should grant the opportunity to buy state-owned oil through processes that are transparent, openly competitive and governed by clear rules so as to secure the best possible price and protect against problems like favoritism, conflicts of interest, patronage and bribery.

NNPC publicly tenders its annual term contracts, in principal. The invitations to tender that it puts out each year do have some language about qualifications, yet some is so broad that it creates almost no real barriers to entry.¹⁵⁰

Past probes have shed some light on how awards actually happen. A 2010 audit found no proof that COMD used performance-based criteria to select term contract holders. Instead, the audit concluded that final choices could be “based on individual discretion and inappropriate criteria” and “might not be transparent and objective.”¹⁵¹ Similarly, NEITI reported that that “the choice of term buyers is taken at higher levels than COMD, implying NNPC’s group managing director (GMD) and the presidency. Decision making is particularly opaque at these levels.”¹⁵² Depending on the government in power, interviewees told us, this higher authority has shifted between the president, petroleum minister, NNPC and various presidential advisors.¹⁵³ A former top NNPC official with responsibility for oil sales explained: “Only a few people inside one or two offices will know what is going on with the deals. Everything is done on a strictly need-to-know basis, even leadership may be kept in the dark.”¹⁵⁴

We asked NNPC Group Managing Director Joseph Dawha about the corporation’s current practices in this area, but we did not receive a response.

An improved system would feature a pre-qualification process that effectively weeds out companies lacking the financial and operational capability to lift and market a cargo of crude, and reflects a coherent, medium-term strategy for securing reliable global demand for Nigerian crude. Publishing the qualifications of the pre-qualified companies would be one way to check whether the criteria are actually applied. NNPC would award the term contract through a tender, with a clear and limited number of biddable terms.

COMD should also publish written rules for parceling out cargoes each month to buyers. A typical term contract indicates a volume figure (e.g., 30,000 barrels per day), but does not promise the holder any specific grades of crude. Instead, NNPC typically marries cargoes to contract holders at joint production and lifting programming meetings which are held one or two months before the oil is ready for lifting. This

NNPC should grant the opportunity to buy state-owned oil through processes that are transparent, openly competitive and governed by clear rules.

COMD should publish written rules for parceling out cargoes each month to buyers.

150 For example, NNPC has specified that a successful applicant must be “a bona fide end user who owns a refinery and/or retail outlets,” “an established and globally recognized large volume trader,” or barring that, merely “a Nigerian registered company with operations in the Nigerian oil and gas industry.” See e.g., NNPC, Invitation for Crude Oil Term Contract Application, 2013. Also here: <http://www.nnpcgroup.com/nnpcbusiness/businessinformation/investmentopportunities/crudeoilmarketing.aspx>

151 KPMG Project Anchor Report sec.3.4.10.

152 NEITI, Audit of the Period 1999-2004 (Popular Version), 2006, p.26, available at: <http://www.neiti.org.ng/sites/default/files/documents/uploads/popularversionof1staudit.pdf>

153 Author interviews, trading company personnel, government officials, IOC staff, industry consultants, 2011-2015.

154 Author interview, 2014.

process is overly opaque and discretionary. Also, NNPC commonly awards term contracts for more crude than it eventually will have to sell—50 percent more in 2011, for example.¹⁵⁵ This creates a monthly bottleneck with traders jockeying to receive cargoes, and it is unclear what strategy or due process COMD follows to manage the competition that ensues. “You have to give something to get something,” one trader claimed.¹⁵⁶ Again, while our research found no clear evidence of specific buyers offering payments to government officials, two traders interviewed acknowledged making such payments to get their preferred grades of oil.¹⁵⁷ Guidelines for allocations, and public disclosures of their utilization, would clear up this unnecessary area of risk.

Develop practices that avoid contract awards and payments to PEPs.

In addition to the basic process improvements described above, NNPC should implement additional safeguards to stem the tradition of awarding contracts to politically connected briefcase companies. NNPC should, at a minimum:

- *Stop selling oil to companies, whether Nigerian or foreign, that:*
 - Never or rarely sell their allocations to refiners.
 - Routinely sell to big trading companies that are already NNPC term customers.
 - Have financial or other ties to PEPs, as determined through due diligence.
- *Use robust due diligence procedures for prospective buyers.* It is unclear how NNPC vets term contract applicants for ties to PEPs or other serious red flags. We asked the corporation about this, but it did not reply.
- *Write and enforce rules against awarding term contracts to companies linked to PEPs.* Some provisions of Nigerian law arguably forbid term contract awards to companies that make payments to PEPs, and punish payment recipients. However, these are not sufficiently explicit, or well enforced.¹⁵⁸
- *Require term contract holders to declare their beneficial owners, and publish the resulting registry of ownership data.* NNPC should require a staff member at each winning company, as part of its tender package, to sign and hand in an affidavit or other statement naming the company’s ultimate beneficial owners. Submission of a false statement should be automatic grounds for revoking a contract, and for legal action by federal prosecutors against the company and staff member. NNPC should publish all of the statements as part of a new oil sales transparency program. (See issue five for details.)¹⁵⁹

It is unclear how NNPC vets term contract applicants for ties to PEPs or other serious red flags.

155 Finding based on comparison of volumes lifted versus awarded in NNPC Annual Statistical Bulletins and NNPC Approved Term Contract Lists.

156 Author interview, 2012.

157 Author interviews, 2010 and 2012.

158 For example, Section 5 of Nigeria’s Code of Conduct Bureau and Tribunal Act states that ‘a public officer shall not put himself in a position where his personal interests conflict with his duties and responsibilities.’ Section 19 of the Corrupt Practices and Other Related Offences Act of 2000 provides that ‘any public officer who uses his office or position to gratify or confer any corrupt or unfair advantage upon himself or any relation or associate of the public officer or any other public officer shall be guilty of an offence and shall on conviction be liable for five (5) years without option of fine.’

159 For more options on beneficial ownership disclosure, see NRG, *Owning Up* (op.cit.).

- *Place limits on buyers’ use of offshore companies.* Many NNPC term contract holders have corporate structures that stretch outside Nigeria. These can include sister companies set up in tax havens and jurisdictions where authorities do not require corporate vehicles to name their beneficial owners. For example, Tridax Oil and Gas Ltd. is a Nigerian entity that won its first term contract in April 2011, a few months after it was registered as a company. According to Nigerian and foreign corporate filings, Tridax’s legal ownership is split between a Nigerian-born, U.S.-based lawyer, a Portuguese investment banker, and a string of shell companies and private investment vehicles running from Nigeria to Switzerland to Malta to Gibraltar (figure 13). How this structure benefits Tridax, NNPC or Nigeria is not immediately apparent, though it has attracted controversy and competing explanations.¹⁶⁰ Tridax and its sister company Mezcors Ltd. have held NNPC term contracts for every year since 2011, and have sold their oil to several buyers.¹⁶¹

Given the risks of PEP payments and tax avoidance discussed earlier, NNPC should develop rules and standards for term contractors’ use of offshore companies, and processes for policing compliance. The corporation should consult with traders, bankers, anti-corruption police and watchdog groups to make the new rules and standards.

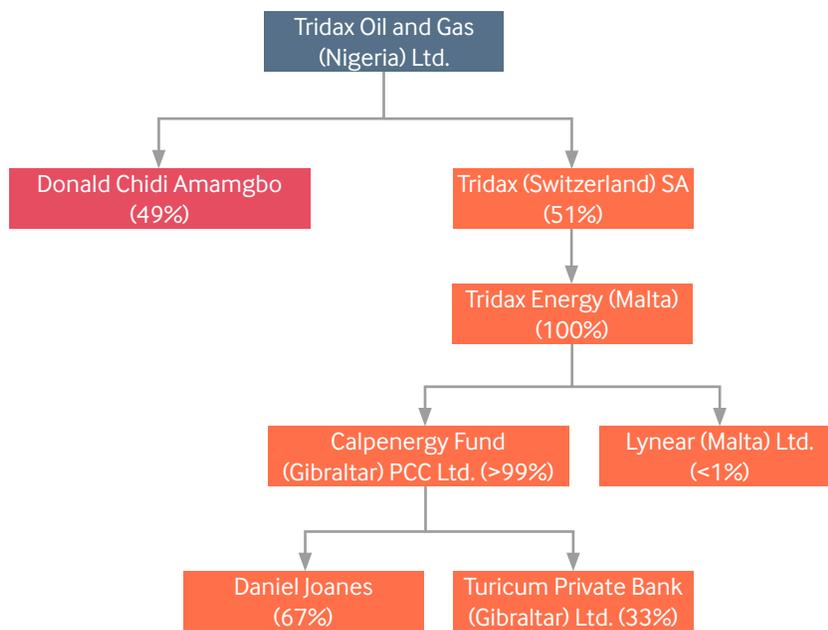


Figure 13: Corporate structure of Tridax Oil and Gas Ltd.

Sources: Nigerian and foreign corporate filings

160 See e.g., Berne Declaration Nigeria Report p. 6; *Africa Energy Intelligence*, “The mysterious Tridax company,” August 28, 2012, available at: <http://www.africaintelligence.com/AEM/oil/2012/08/29/the-mysterious-tridax-company,106905811-ART>; *Handelszeitung*, “Ex-Clariden Leu Banker mischt in Nigeria’s Oel Business mit,” August 28, 2012, available at: <http://www.handelszeitung.ch/unternehmen/ex-clariden-leu-banker-mischt-nigerias-oel-business-mit>; *This Day*, “Tridax, Mezcors debunk claims in Swiss Report,” November 15, 2013, available at: <http://www.thisdaylive.com/articles/tridax-mezcors-debunk-claims-in-swiss-report/164428/>.

161 Vitol lifted all of Tridax’s crude in the 2011 and 2012 annual trading cycles, along with all of the cargoes NNPC earmarked for sister companies Mezcors and Lynear. BP, Glencore and ConocoPhillips 66 handled Tridax and Mezcors cargoes in 2013 and 2014, then Vitol returned as lifter in 2015, disposing of all of Mezcors’s cargoes in the last days of the Jonathan government. Dutch bank ABN Amro provided letters of credit for the companies’ liftings. NNPC Crude Oil Sales Profiles, 2011-2015; market intelligence data; Ministry of Finance Pre-Shipment Inspection Reports.

End government-to-government sales to smaller non-refining countries.

Each year, NNPC builds more middlemen into its sales system when it awards term contracts to foreign governments or other state-owned entities. The corporation’s deals with smaller, mostly African countries that do not refine the oil they buy tend to be especially crowded. The most complex arrangements feature a briefcase company, an experienced trader which manages the deal on behalf of the buyer government and rosters of “agents” who collect small payments for little apparent reason. And since the other countries outsource management of their contracts to traders in exchange for per barrel “commissions” or a share of profits, they behave like middlemen themselves (figure 14).

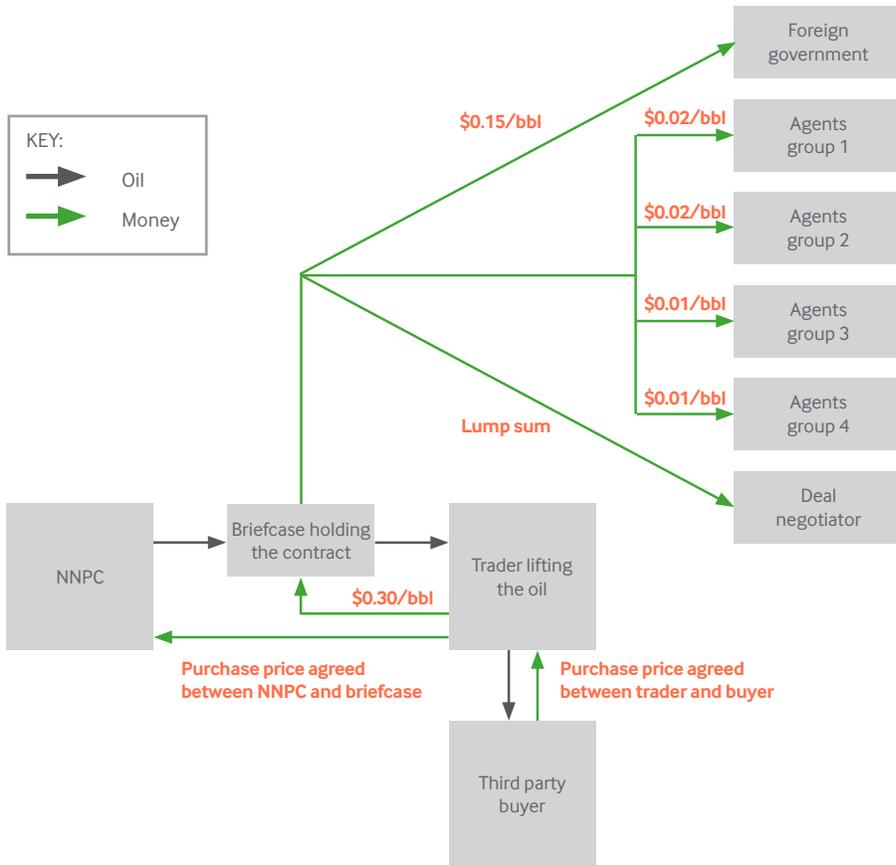


Figure 14: Payments to middlemen pursuant to one NNPC g-to-g oil contract

Source: Accounting document from a smaller country g-to-g deal, on file with NRG.

Scandals in five buyer countries over the 2000s—Jamaica, South Africa, Liberia, Zambia and Malawi (for more detail on these, see the case studies in annex C)—showed that NNPC’s sales to smaller, non-refining countries had no strong financial or policy justifications and came with substantial risks of mismanagement. These deals have sprouted accusations of payments parties made to government officials and the diversion of funds owed to buyer countries. The Zambia g-to-g deal, and its Nigerian-owned intermediary Sarb Energy, featured prominently in the corruption trial of former Zambian president Rupiah Banda. The case ended in an acquittal, but questions remain around payments made by Sarb to accounts connected to Banda’s family members.¹⁶² On the Nigerian side, corporate records checks we performed show that a retired Nigerian general and a former senator had interests in Sarb.¹⁶³

162 *Government of Zambia v. Hon. Rupiah Banda*, Magistrate Court of Lusaka, transcript of trial testimony by Akpan Ekpene.

163 For details, see documents available at www.resourcegovernance.org/publications/inside-NNPC-oil-sales (CAC reports for Sarb Energy, Pixy Energy and Deltoil Ltd.).

Overall, the added layers of complexity and opacity in the smaller non-refining country deals left them open to abuse, and the delivered to Nigeria no clear benefits above what it would have received from selling the oil under less convoluted arrangements. Unless NNPC can publicly explain their policy benefits and reduce the number of politically-connected actors involved, it should discontinue them.

Review the operations of NNPC’s trading subsidiaries; close down poor performers.

NNPC’s trading subsidiaries were originally set up to become NNPC’s main marketers of crude and refined products. But after three decades or more they have acquired limited independent trading capabilities. They receive crude through term contracts from COMD, and then flip the oil to a few big traders. Calson for example assigns most of its cargoes to JV partner Vitol, which takes them to market.¹⁶⁴ “Working for Calson is like being seconded to the London office of Vitol,” said one NNPC official who spent time there.¹⁶⁵ Duke, the one subsidiary that NNPC wholly owns, likewise sells nearly all of its crude to Vitol, Glencore and a few other experienced trading houses for typically undisclosed margins.¹⁶⁶ When PPMC awarded Duke a swap contract in 2011, it outsourced nearly all aspects of managing the contract to three Nigerian trading companies. Acting like many of the extra middlemen in the NNPC oil sales marketplace, Duke retained the right to collect “commissions” from the companies—worth over \$16 million in the deal’s first year (see annex B). As pages 37-38 of this report noted, all of the subsidiaries have opaque governance practices. Neither NNPC nor the subsidiaries disclose how they distribute their earnings, much of which go to offshore accounts.¹⁶⁷

We recommend that the Buhari government subject all of NNPC’s oil trading subsidiaries to an independent operational review conducted by external consultants, carried out in tandem with multi-year financial audits. Those that are found to have weak trading skills and chronic governance problems should be barred from buying more NNPC crude and wound down. Other countries, such as Azerbaijan, Angola and Mexico, have set up affiliated, full-service trading arms that over time gained the capacity to sell directly to end-users and effectively secure top price for their country’s oil. Building up one or more such entities could make sense for NNPC. Its current subsidiaries have not to date indicated an ability to fulfill such a mandate, however.

The added layers of complexity and opacity in the smaller non-refining country deals left them open to abuse.

Other countries, such as Azerbaijan, Angola and Mexico, have set up affiliated, full-service trading arms that over time gained the capacity to sell directly to end-users and effectively secure top price for their country’s oil.

164 Market intelligence data for 2011-15 on file with NRG; author interview with former Calson official, 2014.

165 Author interview, 2011.

166 Market intelligence data for 2011-15 on file with NRG.

167 Author interview, former Duke Oil official, 2014.

Commission a study on the performance of the official selling price (OSP) system.

Stakeholders within and outside of government need to better understand how NNPC sales to middlemen impact the prices the nation obtains for its crude. Our research found no clear, current proof that NNPC's OSP system is grossly manipulated or abused. Overall, pricing is one of the main areas where NNPC export oil sales have improved with time. The use of OSPs should ostensibly limit political interference in pricing: if NNPC strictly applies its formula, the Brent market should typically determine over 90 percent of a cargo's price. Traders claim Nigerian crude tends to be more aggressively priced than similar light sweet barrels—from Libya or Azerbaijan, for instance.¹⁶⁸ Recent audits that reviewed pricing data did not find a consistent pattern of large gaps between OSPs and reported spot market prices for Nigerian crude.¹⁶⁹ The OSP system does represent improvement over the system used in the 1970s, when NNPC staff reportedly set prices using OPEC formulas and top politicians revised them downward for political reasons.¹⁷⁰

Selling oil through intermediaries does not automatically mean less money for an NOC. It is too simplistic to assert that NNPC would always capture a middleman's profits if the corporation sold oil directly to a refiner instead. In theory, intermediary sales should pay NNPC fairly well if the middleman finds a motivated buyer for the oil and shares enough profits with NNPC. Relationships are key in trading, and NNPC may not always have the right ones to make an optimal sale. Marketing through a limited number of traders could also widen the pool of possible buyers, since as a group they will have cultivated more buyer-seller relationships than NNPC. Finally, selling more oil to refiners does not guarantee higher profits: refineries buying crude longer-term sometimes charge heavy discounts for the stable demand they offer.

The main unanswered question with respect to how NNPC prices Nigeria's crude oil is whether the corporation sets OSPs at lower levels so as to allow for payments to intermediaries or their hidden owners. World Bank reviews during the Gen. Sani Abacha years (1993-1998) found that NNPC routinely lowered prices so middlemen could earn larger commissions.¹⁷¹ If a term contract holder has to make payments to a briefcase company (or to the PEP behind a briefcase company) when it lifts NNPC oil, one would expect that it would not buy a cargo unless the cargo's OSP were set low enough to cover the cost of the payment. Buyers agree to buy the cargoes NNPC offers them before knowing the differential, suggesting they are fairly confident of obtaining wide enough margins. Although we have seen no clear proof that NNPC considers buyers' obligations to other middlemen and PEPs when it prices the country's oil, further study is warranted.

168 Author interviews, 2014.

169 See e.g., KPMG Project Anchor Report sec.4.3.1; NEITI 2009-11 Oil and Gas Financial Audit, Appendix B; PwC Report p.47f.

170 Federal Government of Nigeria, Report of the Panel on Crude Oil Production and Marketing Policies, 1976.

171 World Bank, Nigerian National Oil Company Management Audit, 2000; Analysis of the Flow of Funds in Nigeria's Petroleum Sector, Oil and Gas Policy Unit, 2000.

Explore selling more oil directly to refiners.

It would be facile to recommend that NNPC should offer Nigeria’s crude only to refineries. Signing long-term refining deals could be especially risky in the current market, when prices are volatile and US demand for Nigerian crude has softened. Nonetheless, NNPC does not select its term contract holders to broaden its options, nor does it scour the market for best prices. The corporation does little to seek out marketing deals with new end-users, which would be one strategy for developing demand. Buyers at two refineries said they had tried to deal directly with NNPC, but NNPC officials always insisted the refinery buyers go through middlemen.¹⁷² Indeed, since at least the late 1980s NNPC has depended on a small, ever-shifting circle of traders to get Nigeria’s oil to market. These companies are not agents or fiduciaries of NNPC or the nation. They are not obliged to give a fair price to either. On the contrary, their goal is to maximize their own take. NNPC could look beyond its usual customers—especially given the need to find new markets for Nigerian crude.

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Problems	<ul style="list-style-type: none"> NNPC reporting to other government agencies and the public on oil sales is patchy and regularly contains contradictions. The corporation’s own internal recordkeeping systems and processes are disorganized and secretive. The corporation lacks basic checks and balances—for example, no published annual reports, weak audit functions and a board chaired by the petroleum minister.
Recommendation	<p>The presidency should lead a program of transparency and accountability reforms for NNPC, and empower oversight actors to scrutinize the corporation’s decisions.</p>

The new administration should pursue several inter-related accountability goals when reforming NNPC:

- limit political interference
- reduce discretion
- broaden the stakeholders to whom NNPC answers
- end impunity.

When citizens, investors and other public institutions can neither ask nor answer basic questions about how an NOC makes decisions, the likelihood of management in the public interest drops off, as do incentives for efficiency and innovation.¹⁷³ Research has found that *ex post* review of NOC actions by a broad range of stakeholders has better impacts on performance than strong *ex ante* controls imposed by a few influential actors. This is especially so when leaders face real consequences for making bad choices.¹⁷⁴

¹⁷² Author interviews, 2013-2014.

¹⁷³ NRG, *Nine Recommendations* (op.cit.), p.16.

¹⁷⁴ D. Hults, “Hybrid Governance: State Management of National Oil Companies,” in David G. Victor, David Hults and Mark C. Thurber (eds.), *Oil and Governance: State-Owned Enterprises and the World Energy Supply*, Cambridge University Press, 2014, p.62 – 120.

NNPC’s management has a history of resisting outside scrutiny. Past NRGi research found that the corporation “discloses very little about its finances and operations. [...] Even though more than half of public revenues flow through the corporation, [...] no strong legal or policy framework forces NNPC to share information with other stakeholders, and its corporate culture may encourage secrecy.”¹⁷⁵ Within government, NNPC does share some information on oil sale earnings—most notably, in monthly and quarterly reconciliation meetings with around a dozen agencies.¹⁷⁶ It also feeds data on oil sales to FAAC each month. But as the “missing \$20 billion” controversy showed, facts about oil sales are firmly under NNPC’s control. Officials from outside the corporation say they cannot independently verify or challenge the figures NNPC gives them.¹⁷⁷ “We only know what we receive, not what we should receive,” one senior CBN official told us.¹⁷⁸

Government officials from outside the corporation say they cannot independently verify or challenge the figures NNPC gives them.

Some information may not travel widely enough even within NNPC itself. Past reviews described NNPC’s oil sale data management practices as disorganized and secretive. PwC called the corporation’s accounting system for sales “inaccurate and weak,” as evidenced by “significant discrepancies in data from different sources.”¹⁷⁹ During KPMG’s 2010-2011 review, auditors found that information on oil sales was not kept in any “centralized location,” but instead was “stored on individual personal workstations.”¹⁸⁰ Some sales were “not promptly captured in the accounting system,”¹⁸¹ and key data collection processes remained manual and uncoordinated.¹⁸² This apparently led to ineffective debt control, lost or omitted invoices, and sizable data entry errors.¹⁸³ Overall, PwC auditors noted, “there is no single reliable data repository that can provide a holistic overview of the crude oil sales process from end to end. As such, variances in the records which would flag issues may be missed,” and there is no “single point accountability.”¹⁸⁴ As a dramatic example of this problem, the PRSTF, a government task force, found that between 2002 and 2009, separate sets of oil sale books kept by NNPC COMD and NAPIMS sometimes diverged by more than \$100 million per year.¹⁸⁵ NNPC has claimed for some time that it is addressing these challenges by implementing a SAP enterprise accounting system—a costly technological fix that remains unfinished.¹⁸⁶

175 NRGi, *The Petroleum Industry Bill and the Future of NNPC*, 2012, p.14, available at: <http://www.resourcegovernance.org/publications/petroleum-industry-bill-and-future-nnpc>. Elsewhere, a 2010 joint report by NRGi and Transparency International (TI) rated NNPC the least transparent of 44 national and international energy companies surveyed. TI-NRGi, *Promoting Revenue Transparency: 2011 Report on Oil and Gas Companies*, 2011.

176 Members of the Crude Sales Reconciliation Committee are drawn from NNPC COMD, CBN, Budget Office, Office of the Accountant-General, DPR, Finance Ministry, FIRS, National Bureau of Statistics, National Economic Intelligence Committee, National Planning Commission, Nigeria Customs Service, RMAFC. The Committee forwards its results to FAAC, and the FAAC Technical Subcommittee uses these to calculate monthly revenue allocations to the three tiers. For more on the Crude Sales Reconciliation Committee process, see NEITI, 2009-11 *Physical and Process Audit Report*, Appendix G.

177 Author interviews, officials from CBN, Finance Ministry, Auditor-General’s Office, FAAC and NEITI, 2010-14. NNRC Benchmarking Report Sec.2.2.10 (noting that RMAFC and CBN, though they have responsibility for monitoring revenues, “are simply informed of receipts, and little information is provided in terms of revenue projections, under- or over-payments and the breakdown and controls over receipts”).

178 Author interview, 2011.

179 PwC Report p.18.

180 KPMG Report sec. 3.4.9.

181 KPMG Report sec. 3.4.13.

182 PRSTF Report 20f.; NEITI 2005 *Financial Audit*, Appendix A, p.5f.

183 *Ibid.*

184 PwC Report p.51.

185 PRSTF Report p.89. NAPIMS tended to report the larger figures.

186 Author interviews, current and former NNPC officials and contractors, 2010-2013.

Along with improving transparency and information management, the government should also rebuild the collapsed accountability infrastructure around NNPC, empowering heretofore weak oversight institutions and reassuring the heads of such organizations that they have genuine mandates to ask tough questions. Currently, most oversight actors do not make good use of what little information they do receive.¹⁸⁷ Explicit presidential leadership is required on this front. Perceptions run deep in both industry and government that NNPC is a law unto itself: the sacking of former CBN governor Sanusi after he raised questions about oil sale revenues remains fresh in the minds of many.

To enhance accountability, the presidency should ensure that the relevant executive branch agencies:

Along with improving transparency and information management, the government should also rebuild the collapsed accountability infrastructure around NNPC.

Target impunity by auditing and investigating problem areas.

Forward-looking reform of NNPC should be the government's first priority, particularly in this time of low oil prices and economic hardship. However, credible efforts to uncover past abuses can help deter bad practices in the future, and usher in a new era less defined by impunity. Such audits and investigations will face challenges including access to information (e.g., PwC failed to access all the NNPC data that it needed) and the temptation for some officials to use findings to shake down opponents. Political will from the top will be required.

This report identifies a number of areas that would benefit from rigorous forensic examination. Audit findings would inform the broader reform process and identify abuses of power where law enforcement action is needed. We recommend that at a minimum the government commission independent performance audits, with physical, financial, process and value-for-money components, for:

- The DCA
- The crude-oil-for-product swaps
- NPDC oil sales and related operations
- NNPC's oil trading subsidiaries
- Refinery crude oil transport arrangements
- The NNPC fuel import supply chain
- The JV cash call account

¹⁸⁷ For example, NNPC says that it makes its annual financial statements available to the Auditor-General, Accountant-General, House and Senate Public Accounts Committees, and the Fiscal Responsibility Commission, among others. Nigerian National Resource Charter, NNRC 2014 Benchmarking Report, sec.2.3.1, available at: <http://nigerianrc.org/content/2014-nnrc-benchmarking-report>.

Publish more data on NNPC oil sales and financial movements.

The presidency should require NNPC to regularly disclose detailed, cargo-by-cargo data on all of its crude oil sales, to include buyers, grades, vessels, lifting dates, destinations, financing banks, prices obtained and payment details. NEITI and PwC have already put out this information for a number of years, though only after long delays.¹⁸⁸ Currently NNPC only publishes gross lifting volumes and destinations for each type of sale.¹⁸⁹ It last published price data in 2008 and revenue information in 2005. A good first step would be for the government to require the corporation to issue an annual report for 2015 that would also include its audited financial statements, operational data, the financial positions and earnings of its subsidiaries, and disclosures on quasi-fiscal and other discretionary spending. Most sophisticated NOCs issue annual reports; the publications of companies like Petronas, Ecopetrol, Statoil and others could be used as models. The central bank and finance ministry should also make more detailed reporting on oil sale revenues in their publications, including disaggregation by sales types.

The presidency should require NNPC to regularly disclose detailed, cargo-by-cargo data on all of its crude oil sales.

Commission regular external audits of NNPC, and publish the reports.

According to past NRGi research, NOCs with strong audit and reporting requirements tend to realize better returns from their operations.¹⁹⁰ Periodically—though perhaps not regularly—audits of NNPC, its subsidiaries and corporate divisions do take place. But the quality of audit functions and management responses are questionable. In 2010, KPMG found that the NNPC board’s audit committee met just once in three years, the plan used for audits was not approved by directors, and the full board apparently did not discuss or approve internal audit plans or results at its meetings. The corporate audit division reported directly to the group managing director—a possible threat to its independence.

Most sophisticated NOCs issue annual reports; the publications of companies like Petronas, Ecopetrol, Statoil and others could be used as models.

Specific to oil sales, KPMG auditors examined reports from annual audits of COMD and found that management did not address red flags on transactions and financial movements worth \$2.59 billion.¹⁹¹ Auditors also routinely complain that NNPC does not give them access to people or data they need to do their work.¹⁹² In their 2014-2015 review, PwC auditors concluded that “the lack of independent audit and reconciliation [for NNPC oil sales] led to over reliance on data produced from NNPC. This matter is further compounded by the lack of independence within NNPC as the business has conflicting interests of being a stand-alone self-funding entity and also the main source of revenue to the Federation Account.”¹⁹³

Other NOCs exhibit good practices that NNPC should follow. These include hiring external, independent firms to conduct audits, publishing the audit reports, hiring auditors through open tenders, and changing auditors periodically.

188 See e.g., NEITI, 2009-11 Oil and Gas Physical and Process Audit Report, Appendix B, p.19.; PwC Report p.112.

189 NNPC Annual Statistical Bulletins.

190 NRGi, Nine Recommendations (op.cit.), p.18.

191 KPMG Project Anchor Report sec.9.3.11.

192 See e.g., Senate Finance Committee Report p.36; PRSTF Report p.126; PwC Report p.13, 17, 19, 26, 81, 83, 196.

193 PwC Report p.51.

Empower accountability actors.

To create more effective checks on NNPC's decision-making, the new administration could:

- Require NNPC to establish clear performance benchmarks, for the year and for the medium-term. These should include spending levels, tied to the corporation's actual budget proposals. NNPC should circulate these benchmarks to relevant government entities including the National Assembly (NASS), report against them on an annual basis, and use them as a basis against performance can be concretely assessed. This approach affords NNPC some autonomy (the NASS should not, for instance, get involved in various business decisions), while injecting some accountability into a system where it is sorely lacking.
- Clarify the extent of the Auditor-General of the Federation's powers to audit NNPC, and have its reports published online.
- Expand the Accountant-General of the Federation's role in reconciling and reporting on NNPC revenues, including oil sale revenues.
- Provide more resources and independence to the Economic and Financial Crimes Commission (EFCC), including its Oil and Gas Unit, to allow it to pursue high-level cases involving oil-related financial crimes.
- Ensure NEITI has the funds, independence and mandate it needs to rigorously report on the full scope of NNPC operations and finances, and encourage NEITI to publish reports in a more timely fashion.

The new administration should require NNPC to meet clear performance benchmarks.

Guard against known governance risks.

To further strengthen NNPC accountability and adopt a strong reform posture, the presidency should develop and oversee an agenda under which the relevant agencies:

- Propose amendments to the 1977 NNPC Act to remove the petroleum minister as chair of the NNPC board, appoint a board constituted by a majority of independent professionals, and ensure that the board meets regularly.
- Restore CBN's full authority as joint signatory to the Crude Oil Naira and Dollar Accounts.
- Sanction NNPC officials for refusing to cooperate with audits or parliamentary probes.
- Publicly support and protect the tenures of officials in other agencies who justifiably question NNPC management decisions.
- Require oil sector officials, including senior officials at the NNPC and its subsidiaries, to declare their assets, starting when they take office.
- Establish more open, productive relationships with civil society and the media on oil sector issues.
- Investigate and prosecute oil sector officials for misconduct while in office.

Solving NNPC's underlying problems

As we suggested at the beginning of this report, maximizing full returns from NNPC oil sales will depend on pursuing two trajectories of reform—the urgent fixes mentioned above, and a broader agenda of NNPC restructuring. Many of the worst performance problems found with NNPC's current sales system are byproducts of larger, longstanding, well known challenges that have eluded reform for many years, including through the chronic delays that prevented the passage of the PIB. By stalling sector reform, NNPC bosses have created a legal, operational and political limbo that influential officials in and outside of the corporation exploit in the service of narrow, short-term interests. Weak accountability means that bad management decisions, possibly criminal conduct included, have gone largely unpunished.

The dramatic rise of oil prices in the late 2000s made it easier for NNPC to “muddle through,” with extra cash flow masking the inadequacy of various short-term fixes. This, in turn, further delayed action on addressing the larger, structural problems. Many of the stop-gap measures were introduced to fight fires, or re-route oil sale earnings. Over time, top officials have expanded, reworked and manipulated some of them in order to distribute patronage benefits. But now, faced with lower oil prices and sales premiums, rising industry costs, a growing list of suspect NNPC deals and withholdings, and drained government coffers, the government should undertake systemic reform, rather than creating another round of ill-suited coping mechanisms.

Below we recommend a number of fundamental fixes to Nigeria's oil sector governance. This list is certainly not exhaustive; we focus here on those issues that relate specifically to oil sales. For instance, we do not discuss the role of NAPIMS, the NNPC subsidiary in charge of negotiating and enforcing contracts, the operations of which are fraught with inefficiency and conflicts of interest. Also, this agenda does not require omnibus sector legislation, such as the Petroleum Industry Bill. In fact, the far-reaching nature of the bill attracted too much political baggage, and the timeline of its implementation would have far exceeded the political horizons of any leader. Taking up the agenda in workable segments is the way to achieve results.

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Taking up the agenda in workable segments is the way to achieve results.

Develop a plan for funding NNPC JV cash calls.

The cash call system is fundamentally broken. For more than decade, NNPC has lacked the capital it needs to grow its asset base or meet upstream operating costs. This is partly because the federal government has not funded it adequately through the annual budget process, partly because funds have been diverted for other purposes. The corporation has amassed growing, multibillion dollar cash call debts, many of which it settles years late, if at all (figure 15).¹⁹⁴ The resulting funding crisis set NNPC on the path of inventing makeshift methods for funding its obligations, both to the JVs and more generally.

Year	Total JV budget (\$ billion)	NNPC's share, estimated at 58 percent (\$ billion)	Actually paid by NNPC (\$ billion)	Debt to operators (\$ billion)
2006	8.1	4.7	4.1	0.6
2007	9.7	5.6	4.3	1.3
2008	12.4	7.2	4.9	2.3
2009	14.8	8.6	5.4	3.2
2010	17.7	10.3	6.2	4.1
2011	17.2	9.9	5.2	4.7
2012	18.0	10.4	6.9	3.5

Figure 15: JV cash calls, budgeted versus paid, 2006-2012

Sources: Author estimates based on data from PRSTF Report p.78; NEITI 2012 Audit Report p.103

Costs to Nigeria have already been high, from the actual interest payments associated with this lending to the lost revenues as field maintenance and investment are neglected. A functioning corporate finance model is a strong predictor of NOC performance. Companies that lack reliable access to enough revenue to cover their operational costs lose significant profits as a result.¹⁹⁵ Over the last decade, JV funding issues have meant delayed projects and lower production and revenue receipts for Nigeria.

To bridge some of the financing gaps, NNPC has entered into a series of makeshift arrangements in which opacity, complexity and governance risks are relatively high:

- Third party project financing deals
- Carry agreements and modified carry agreements (MCAs)
- IOC bridge loans¹⁹⁶
- The SAAs discussed on pages 40 to 41.

Roughly a third of JV production now happens under these alternative finance arrangements (figure 16). As a group, these deals come with unclear costs and shrink the total volumes of crude oil that NNPC has to sell.¹⁹⁷

Over the last decade, JV funding issues have meant delayed projects and lower production and revenue receipts for Nigeria.

194 In 2012, for instance, NNPC paid JV operators \$1.253 billion in cash call arrears dating back to 2002-2009. NEITI, 2012 Oil and Gas Audit Report p.104.

195 NRG, Nine Recommendations (op.cit.), p.9.

196 For explanation of these deals, see NEITI, 2012 Oil and Gas Audit Report p.77f.

197 NEITI found, for instance, that despite the increase in crude oil production during 2009-2011 by 4.8% 2006-2008, NNPC's share of total exports declined by 15.5% within the audit period in comparison to the last audit cycle. NEITI attributed this partly to NNPC's use of its equity crude oil entitlements to fund JV operations through alternative funding arrangements. NEITI, Remediation Plan Part B, item 2.1.

Item	2009	2010	2011	2012	2013	2014
Alt. finance production ('000b/d)	360	455	474	412	290	385
Total JV production ('000b/d)	1,268	1,454	1,429	1,274	1,093	1,087
Alt. finance as percentage of JV	28	31	33	32	27	35

Figure 16: Alternative finance production as a share of total JV production, 2009-2014

Source: NNPC Annual Statistical Bulletins, 2009-2014

The government should urgently explore other options for funding JV operations. Given the current state of play, the best arrangements would have to transfer much of the financial burden and risk to privately owned companies. NNPC’s status as a statutory corporation with large debts and no credit rating means it cannot negotiate much external debt financing on its own. The most immediately accessible—though by no means the only—options are:

- *Selling off NNPC equity, either by divesting physical assets or listing corporate shares on a stock exchange, to raise capital for priority investments.* This is perhaps the most appealing and practical step for now as it raises money, lowers future liabilities and helps right-size NNPC. If necessary, the state could maintain a minimum shareholding as a non-controlling financial interest (a common practice), which would enable it to maintain representation on management committees, etc. The sale process would require very high levels of protections and accountability to avoid the kinds of manipulation and underpricing observed in other countries.
- *Converting the existing JVs to independent joint ventures (IJVs) so they can raise their own funds.* This option was proposed in a previous version of the PIB, under the government of Umaru Yar’Adua. While interesting, this would take time: banks are unlikely to lend to IJVs until NNPC establishes a track record of better governance.
- *Entering into new risk-sharing arrangements such as better-established carry agreements, PSCs or service contracts.* NNPC could also enter into new operational agreements that would require the private companies involved to pay its share of project costs up-front and recoup their expenses in oil. Service contracts may result in a greater role for NNPC, exceeding its capacity. As such, the corporation should consider them with caution. It could negotiate the new agreements alongside the sale of JV equity.

Given the current state of play, the best arrangements would have to transfer much of the financial burden and risk to privately owned companies.

Eliminate the fuel subsidy.

NNPC's habit of unilaterally holding back billions in DCA revenues each year, supposedly to cover its losses from selling gasoline and kerosene at subsidized prices, has become financially untenable for both the corporation and the nation. PwC found that NNPC withheld \$8.76 billion in domestic crude earnings for subsidy in just nineteen months. Investigations from the 2012 fuel subsidy scandal revealed the scale of governance failures and revenue losses that had developed within those transactions. The main winners seem to have been traders and the government officials who assist and receive benefits from them.¹⁹⁸ The fuel subsidy system also does not reliably deliver affordable fuel to ordinary Nigerians—its intended goal.

There has never been a better time to end the subsidy, whether immediately or in a phased drawdown. The new government enjoys goodwill, fuel prices are low, an unprecedented number of key stakeholders are on board, and the ongoing fuel shortage highlights the dysfunction of the current system. If full removal cannot happen right away, NNPC in the interim should be forced to queue for its fuel subsidy claims from the Petroleum Support Fund (PSF) like other marketers, and be stripped of its ability to appropriate the claims directly from DCA proceeds.

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Remove NNPC as a commercial player from the downstream sector.

We recommend that the Nigerian government sell off all of NNPC's downstream businesses assets, including the refineries, to stop the growing, unsustainable losses from them. If the administration decides to retain an interest in the assets, it should at the most keep a small minority stake and cede operational and financial control to qualified private companies.

As already explained (see pages 30-34), NNPC withholds billions of dollars a year from the DCA purportedly to cover the costs of running its downstream businesses. Much of the expenditure is traceable to poor management decisions, waste and corruption. For years, NNPC's chronically underperforming refineries have kept Nigeria dependent on costly fuel imports. Once the fuel arrives, PPMC records huge losses from its transportation and storage infrastructure—at times PPMC loses more than 40 percent of all product to sabotage, theft and equipment failure.¹⁹⁹ As refining costs have risen, outputs have actually fallen—especially after 2003, when the government eased out subsidies on the crude it piped to the refineries.²⁰⁰ NNPC says downstream expenses are the biggest drag on its financial position, despite the billions of dollars it withholds from domestic crude sale proceeds each year.²⁰¹

NNPC has had many chances to reform its downstream businesses. The results strongly suggest that the executive should not give NNPC more public funds for this purpose. Hundreds of millions of dollars spent on turnaround maintenance (TAM) did not sustainably improve refinery performance. Past government-commissioned studies concluded that it would take billions more to return PPMC's transportation and storage infrastructure to basic functionality—expenses which NNPC cannot afford.²⁰² The corporation has never given the refineries a sound business model, cost

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¹⁹⁸ For more on mismanagement of the fuel subsidy, see annex A and annex B section 4.1.

¹⁹⁹ See e.g., PRSTF Report p.102.

²⁰⁰ For more on this point, see NEITI, 1999-2004 Process Audit: Refineries and Product Importation, 2006, p.15.

²⁰¹ NNPC, Further Responses to the Observations of Forensic Examiners ("NNPC Responses to KPMG Project Anchor Report"), sec., 7.2.3.1.

²⁰² One 2010 study by AON Energy Risk Engineering reportedly estimated full rehabilitation costs at \$8.94

recovery mechanism, or governance framework, nor sufficient financial and operational autonomy.²⁰³ At times NNPC does not even supply the refineries with crude. These are not anomalies that a few good policy choices can put right. They are decades-old dysfunctions that cannot be reversed.

As operating conditions have worsened and no easy fixes have emerged, NNPC has resorted to increasingly questionable stop-gap measures, especially in the last five years. Violent Niger Delta actors were paid to guard pipelines, yet theft actually increased—by over 500 percent in some areas.²⁰⁴ Faced with stagnant refinery outputs, NNPC ran up over \$3 billion in debts to fuel suppliers. It settled part of these claims by mortgaging 15,000 barrels per day of future oil production in exchange for a syndicated bank loan; NNPC is still over \$1 billion in arrears for that.²⁰⁵ Still left with hemorrhaging pipelines and no credit to buy imported gasoline or kerosene, the corporation fell back on more costly, opaque deals like the crude-for-product swaps and the refinery marine crude oil transport arrangements. Despite all of this activity, in 2014 the refineries ran at only 14 percent of capacity—their worst performance in years.²⁰⁶ Nigerians have borne the costs of all this, whether through misspent revenues and underfunded social programming, periodic fuel scarcities, grassroots Delta violence over rights to stolen crude and products, or having to buy over-priced, adulterated fuel.

Some will argue that Nigeria cannot risk ceding control of such important national assets to a narrow band of self-interested private actors. But in effect, it already did, decades ago. Ordinary citizens are not the main beneficiaries of NNPC's unreliable refineries; leaky, decrepit pipelines, jetties, fuel depots and tank farms; poorly supplied filling stations; costly fuel import, infrastructure protection and maintenance contracts; or questionable, poorly documented fuel subsidies. For years, all of these have best served the traders, service contractors, government officials, powerbrokers, middlemen, police and soldiers, smugglers, militants, gang members and other criminals who benefit from the various rackets around transportation, distribution and sales of NNPC fuel.²⁰⁷ The corporation's fuel supply chain is already captured, by groups with no strong incentives to run it sustainably or for the public good. A few new policies or maintenance outlays will not loosen the dense knot of political interests around it.

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Total privatization of the Nigerian fuel market likely will bring its own dysfunctions and abuses, especially at first. Although several government-commissioned reports have argued for it,²⁰⁸ no one has come up with a clear downstream privatization and deregulation plan, so there is work to be done.²⁰⁹ A tightly run competitive process would be essential to avoid problems observed in other countries, including the sale of assets at deflated prices and blatant favoritism of political insiders.²¹⁰ Even with these

billion. Cited in the Kalu Task Force Report p.40-41.

203 Id. p.7f.

204 For more on this point, see annex A.

205 Reuters, "Nigeria state oil company borrows \$1.5 bln to pay fuel debt – source," January 7, 2013, available at: <http://www.reuters.com/article/2013/01/07/nigeria-loan-idUSL5E9C798R20130107>; author interviews, trading company personnel and government officials, 2011-15.

206 2014 NNPC Annual Statistical Bulletin p.iv, 39.

207 For more on this point, see annex B section 5.

208 See e.g., OGIC 2 Report p.42, Kalu Task Force Report p.9.

209 See e.g., Aaron Sayne, Presentation: The Petroleum Industry Bill and Its Implications for A Deregulated Downstream Sector, reprinted as Annex 4B of the House of Representatives Committee on Petroleum Resources (Downstream), Proceedings of the Downstream Stakeholders Forum, November 2012, available at: http://tandice-bsolutions.com/rokdownloads/downstream_stakeholders_forum/FINALREPORTONTHEDOWNSTREAM%20STAKEHOLDERS.pdf.

210 Examples abound, including from post-Soviet countries in the 1990s and more recent asset sales by the national mining company in the Democratic Republic of Congo. See, for instance, Carol Leonard and David

safeguards, Nigeria may struggle to net a high return for some of these struggling assets. But in their current state, NNPC's downstream operations constitute an unpolicable, unfixable, multi-billion dollar cost center that hides and enables endemic waste and corruption. The huge public resources poured in should be spent elsewhere.

Develop and start implementing a road map for restructuring and commercializing NNPC.

The prior two recommendations are linked to what is perhaps the biggest question of all in Nigerian oil and gas: what sort of entity does NNPC need to become in order to make money, serve the public interest, and facilitate growth in the oil sector? At a minimum, the corporation needs a new ownership structure, stronger operating mandate, clarified commercial and non-commercial roles, limits on quasi-fiscal and other questionable spending, and a corporate governance framework that allows for accountable, productive decision-making, starting at the board level.²¹¹

Since the early 2000s, plans for restructuring NNPC have been bound up with the debate around the PIB. Yet no draft of the bill has offered a clear, detailed transition framework for getting NNPC from where it is now to where it could be.²¹² Moreover, given the PIB's dim legislative prospects and unwieldy breadth, the government will need a new vehicle for charting NNPC's future, born of a fresh legislative process.

Develop a credible, politically backed action plan for tackling crude oil theft.

A full examination of Nigeria's oil theft problem is beyond the scope of this report.²¹³ Nonetheless, the phenomenon cannot go unremarked. Since the 1980s—and possibly before—organized criminal networks have been stealing Nigeria's oil from production infrastructure and even some oil export terminals. No one has been able to confidently quantify the volumes lost, but average estimates vary from 50,000 to over 250,000 barrels per day. Some of the lost oil is refined locally; tankers owned by middlemen and politicians, or chartered by rogue oil trading and shipping companies, abscond with the rest to foreign countries.

Given the PIB's dim legislative prospects and unwieldy breadth, the government should find a new vehicle for charting NNPC's future, born of a fresh legislative process.

Pitt-Watson (2015), *Privatization and Transition in Russia in the Early 1990s*, New York: Routledge; and Africa Progress Panel (2013), *Equity in Extractives*.

211 See Aaron Sayne et al., *The Petroleum Industry Bill and the Future of NNPC*, RWI Briefing, October 2012, available at: http://www.resourcegovernance.org/sites/default/files/rwi_bp_nnpc_synth_rev2.pdf.

212 Ibid.

213 For more detailed analysis and recommendations, see Katsouris and Sayne *Oil Theft Report*.

It would be naive to classify Nigerian oil theft simply as a law enforcement or security problem. Officials at the very top of government have condoned—and in some cases, helped run—a parallel illegal export market. This hurts the performance and integrity of the legal market in several ways. Most obviously, theft means that NNPC has several billion dollars’ worth of oil less to sell yearly,²¹⁴ and dents premiums paid for some grades.²¹⁵ As noted above, lost revenues and production stoppages from theft have forced the government to dip into savings to fund itself, especially since 2012. Over time, some individuals and companies suspected of stealing oil even have won their own NNPC term contracts, which has offered them legitimacy—and possibly, more funds to grow their businesses in Nigeria and overseas.²¹⁶

In over three decades, no Nigerian administration has pushed hard against oil theft. Successive governments have acted only when losses reached unmanageable levels, mostly relying on *ad hoc* displays of military might and closed-door political settlements. Nigeria’s main trade and diplomatic partners have taken no real action, and no group outside of government has a record of sustained, serious engagement. Given the strong influence and incentives of the groups that profit—top politicians and military officers, militants, oil company personnel, rogue oil traders, communities and a gaggle of local and international facilitators—it is difficult to identify solutions that might help without a marked shift in political incentives. The coming years will determine whether the 2015 transition in government will lead to such a shift.

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214 We make no attempt here quantify the value of the oil stolen, given the failure of all relevant stakeholders in government and industry to keep and/or disclose reliable records on volumes lost. For more on this point, see *id.*, p.25.

215 Author interviews, trading company personnel, price reporting service journalists, industry personnel, 2012-2014.

216 Author interviews, trading company personnel, IOC staff, government officials, industry consultants and law enforcement personnel, 2010-2015.

Conclusion

In December 2012—four months after receiving the findings of the Petroleum Revenue Special Task Force, the latest in a long line of reports detailing NNPC’s performance woes—petroleum minister Diezani Alison-Madueke told a group of reporters in Vienna that Nigeria had no plans to reform its oil sales. “The issue of changing the way we sell our oil has been looked at by NNPC who do not feel there is a major problem with that,” said the minister.²¹⁷ At the time Brent crude was trading above \$100 a barrel. The country had over \$20 billion more in gross foreign reserves and savings than it does now. The Sanusi scandal was a year away.

Nigeria can no longer afford to leave NNPC’s inefficient, secretive, overly convoluted oil sales system untouched. Particularly in this time of low oil prices, soft demand for Nigerian crude, rising oil sector operating costs, and weakened fiscal buffers, the current model is unsustainable for both the corporation and the nation. Keeping the status quo would cost Nigeria billions of dollars a year, obstruct broader efforts at oil sector reform, and make way for further political controversy. As things stand, Sanusi’s “missing \$20 billion” claims remain unresolved (see annex A, box 1) and further billion dollar accusations are being made.²¹⁸

The current climate, with its change of leadership and the immediate need to boost oil revenues, offers Nigeria its best chance in years for overhauling NNPC’s oil sales, along with the corporation’s larger structures, practices and culture. If implemented, the reforms recommended in this report would give the government a solid foundation for remaking NNPC into a company that serves the interests of the nation’s 170 million citizens.

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217 *Reuters*, “Nigeria has no plans to reform its oil sales,” December 13, 2012, available at: <http://www.reuters.com/article/2012/12/13/nigeria-oil-idUSL5E8NC6MB20121213>

218 In June 2015, members of the National Economic Council (NEC) alleged that NNPC remitted barely half (N4.3 trillion, approx. \$27.7 billion) of a purported N8.1 trillion (\$52.2 trillion) it earned between 2012 and early 2015. A committee was set up to review the allegation. <http://www.punchng.com/news/nec-sets-up-committee-to-probe-nnpc-missing-funds>. Unpublished documents from a FAAC subcommittee put the corporation’s 2011-2014 withholdings from domestic crude sales alone at N4.259 trillion (\$27.4 billion). FAAC Post-Mortem Subcommittee, FAAC Analysis for the Month of January, 2015, February 2015, p.9. We cannot independently confirm the accuracy of these figures.

Abbreviations

AENR	Agip Energy and Natural Resources Nigeria Ltd.	NNPC	Nigerian National Petroleum Corporation
AFRA	average freight rate assessment	NOC	national oil company
APC	All Progressives Congress	Nocma	National Oil Company of Malawi
b/d	barrels per day	NPDC	Nigerian Petroleum Development Company
bbIs	barrels	NSIA	Nigerian Sovereign Investment Authority
B/L	bill of lading	OML	oil mining license
BRICs	Brazil, Russia, India, China	OPA	offshore processing agreement
CAC	Corporate Affairs Commission	OSP	official selling price
CBN	Central Bank of Nigeria	OSP	official selling price
COMD	Crude Oil Marketing Division	PEP	politically exposed person
DCA	Domestic Crude Allocation	PIB	Petroleum Industry Bill
DPK	dual purpose kerosene	PMS	premium motor spirit
DPR	Department of Petroleum Resources	PPMC	Pipelines and Product Marketing Company, Ltd.
DSS	Department of State Services	PPPRA	Petroleum Products Pricing and Regulatory Authority
ECA	Excess Crude Account	PRSTF	Petroleum Revenue Special Task Force
ECOWAS	Economic Community of West African States	PSC	production sharing contract
EFCC	Economic and Financial Crimes Commission	PSF	Petroleum Support Fund
FAAC	Federal Account Allocation Committee	PwC	PriceWaterhouseCoopers
G-to-g	government-to-government	RF&L	refining fuel and loss
IOC	international oil company	RMAFC	Revenue Mobilisation, Allocation and Fiscal Commission
JV	joint venture	RPEA	refined product exchange agreement
L/Cs	letters of credit	SAA	strategic alliance agreement
LPG	liquefied petroleum gas	SAOC	South African Oil Company
LPRC	Liberia Petroleum Refining Corporation	SIR	Société Ivoirienne de Raffinage
MCA	modified carry agreement	STS	ship-to-ship transfer
MT	metric ton	VGO	vacuum gasoil
NAPIMS	National Petroleum Investment Management Services	VLCC	very large crude carrier
NEITI	Nigeria Extractive Industries Transparency Initiative		



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