The Nigerian Petroleum Industry Bill: Key Upstream Questions for the National Assembly

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Nigeria's Petroleum Industry Bill (PIB) represents an ambitious attempt to implement much-needed reform to the structure, governance, and fiscal rules of the country's oil industry, which has been beset for years by corruption and inefficiency. The Bill is a massive and imperfect piece of legislation, and the debate around it has been contentious and multi-faceted. This memorandum analyzes the PIB's approach to petroleum-sector reform in Nigeria and spells out some of the key questions the National Assembly should consider as it reviews the Bill.

The Revenue Watch Institute (RWI)[1] believes that the stated goals of the PIB—to transform the oil industry into an engine of sustainable development, enhance governance, and eliminate toxic social and environmental impacts on producing communities—are necessary and long overdue in Nigeria, where the current legal and institutional system has produced massive corruption, little protection from environmental and social damage, and billions of dollars in lost revenue. Whether or not the Bill ultimately advances these goals will depend upon a number of fundamental policy choices by the Nigerian people and their representatives. As the Nigerian legislature and civil society seek to interpret Bill and get to the core of these key policy questions, they must understand certain technical considerations regarding the restructuring of the upstream sector.[2] Among them are:

1. Reconciling Gaps and Discrepancies in the Different Versions of the Bill

Members of the executive branch have made public at least two versions of the PIB, and there are rumors of a third, sparking significant confusion. The official version is the original document submitted to the National Assembly, and for ease of managing the legislative process, the Assembly needs to focus its efforts on one working document. However, this version contains several apparent gaps, most notably relating to the fiscal regimes that will govern the sector. The second version of the Bill, submitted as a memorandum by an inter-agency group including the Nigerian National Petroleum Corporation (NNPC), the Department of Petroleum Resources (DPR), the Federal Inland Revenue Service (FIRS), and the Nigeria Extractive Industries Transparency Initiative (NEITI) (hereinafter the "memorandum version"), attempts to fill in

[1] The Revenue Watch Institute (RWI) works with civil society, legislatures, and governments across the world to develop and implement legal regimes that help citizens get the most out of their nations' natural resource wealth.

[2] This analysis does not cover the changes proposed in the PIB to the downstream sector, though such issues are of critical importance to the country. Nor does it address issues of revenue sharing among the Nigerian states or the physical location of institutions to be established for management and training in the petroleum industry.

several of these gaps by adding provisions and details on various important subjects including (1) taxes and royalties (Part XIII of the memorandum version), (2) community development and local content (§413), (3) the management of the midstream sector (Part E), (4) the structure of regulatory institutions, and (5) transparency of revenue and cost data (§273).[3] Because these are important and necessary considerations, the legislature should consider including them, despite the executive's unclear management of proposals.

Key Questions and Actions for the Legislature:

- For each issue on which the two drafts advocate different approaches, what is the government's official position?
- Are there provisions in the memorandum version of the Bill regarding the five subjects listed above or other important discrepancies that should be incorporated in revisions to the official version?

2. Restructuring of Government Oversight Bodies

The Bill seeks to replace the current NNPC-dominated system with a new oversight structure wherein a National Petroleum Directorate sets policy and three new agencies regulate implementation. Removing NNPC's regulatory responsibilities will reduce one form of conflict of interest that has plagued the Nigerian oil industry. But simply replacing one inefficient institution with three new institutions does not solve any problems—and indeed could exacerbate bureaucratic inefficiencies—unless there are clear provisions for the governance of these new institutions. At present, the Bill does not appear to adequately ensure the effective independent management of the new bodies.

Provisions for legislative oversight of the new bodies are minimal, and the President and the Minister appear to retain significant discretion over the activities of the most important institutions responsible for upstream policy-setting and regulation: the Directorate, which would develop the government's overarching petroleum strategy and coordinate regulatory agencies' activities; the Nigerian Petroleum Inspectorate, which would serve as the principal regulator of upstream operations, administer licenses and leases, and promote health and environmental standards; and the National Petroleum Assets Management Agency (NAPAMA), which would monitor and approve costs incurred by oil companies in upstream operations. The Directors-General and board members of all three bodies would be appointed and removed at the President's direction. The Inspectorate must submit mid-year and annual reports and audits to the National Assembly, but the Assembly has no fixed power to approve or reject those reports or to supervise the Inspectorate's budget, which is set by its own governing board. And neither the Directorate nor NAPAMA would face any requirement to submit reports or budget documents to the Assembly or the public.

A provision in §28 of the PIB allowing the Directorate to directly collect up to 2% of "fiscalised crude or fiscalised natural gas"[4] has the potential to be a source of confusion and corruption,

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[3] Except where noted, the analysis in the remainder of this document will focus on the official version of the Bill.

[4] The payment appears to be on the gross value of crude oil at the point of export. The Bill defines "fiscalised crude" as "the net quantity of crude oil produced in a batch or cargo ready for export after the removal of solid and liquid impurities of the crude; or the total quantum of crude oil at standard

especially given the lack of independent oversight of the Directorate's budget. The Bill provides no standard for how the Directorate is to set the regulatory-agency budgets which would determine how much the Directorate would collect (up to the 2% maximum), or the process by which payments are to calculated, collected or audited. The collection of these payments to the Directorate's account would be managed by a self-interested body, and would bypass both the ordinary channels for revenue collection through the Federation account and the ordinary processes by which federal agency budgets are determined.

Key Questions and Actions for the Legislature:

- Do the proposed rules on the structure and governance of the new institutions accomplish the major goals of the administrative reform? If not, what additional oversight measures are necessary to ensure the effective functioning of the new bodies?
- Do risks associated with the Directorate's ability to collect revenues for itself outweigh the potential benefits associated with the proposal (which include speed of funds accrual and minimization of bureaucratic delays)?

3. Restructuring of NNPC and Governance of Incorporated Joint Ventures

As with the oversight bodies, the PIB seeks to eliminate the national oil company's current problematic structure without enacting adequate guarantees that the alternative will function better. The Bill envisions that NNPC will continue to exist in the form of NNPC Limited, and that some of its shares may be put on the Nigerian stock exchange. But it does little to spell out what NNPC's responsibilities will be under the new system, how its performance will be assessed, who within government will constitute its shareholders, how it will pay dividends to the government in the event of profits or how the question of divesting the company of some shares will be decided.

NNPC's equity participation in joint ventures should continue to generate a major share of the financial benefits Nigeria derives from the petroleum sector. Consequently, the Bill needs a clearer delineation of government controls over the company, including guidance on who appoints and oversees the Board. The Bill suggests that the articles of incorporation of NNPC Limited will establish some important details, and indeed many countries establish details of national oil company management in such articles or in a separate constitutive act rather than in the main petroleum legislation. But given that the PIB calls for eliminating NNPC's current responsibilities and governance structure while leaving massive public assets vested in the company, the Assembly should demand more clarity about the new NNPC Limited before deciding on the Bill.

Besides the internal government oversight of the company, the Bill also leaves the governance of the Incorporated Joint Ventures unresolved, which will likely lead to intense debates between the government, NNPC and private companies. The scope of NNPC Limited's responsibilities on the boards of the IJVs will play a major role in shaping their operations. Private companies will likely push for a dominant role in IJV decision-making, as they seek to avoid the bureaucratic inefficiency that has long characterized petroleum operations in Nigeria. The government may

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temperature and pressure that is produced and metered at all export terminals in Nigeria or at the delivery point to the refinery in Nigeria, multiplied by the posted prices."

wish to promote the interests of the country via a strong position for NNPC on IJV boards, or it may choose to have the national company play a quieter role, exercising public control via the regulatory bodies. There are risks and benefits to both approaches, but the PIB gives little indication of a coherent strategy. This vagueness unpredictability has contributed to international oil company discomfort with the PIB, and unless the chosen approach is clarified, negotiations could be disjointed and difficult for the government to manage.

Key Questions and Actions for the Legislature:

- The National Assembly should demand more clarity in the Bill as regards NNPC's relationship with the government, its financial obligations vis-à-vis the state, and its role in the IJVs. Leaving key details of corporate governance up to negotiations without a clear policy mandate can lead to corruption and imperil the goal of coherent sector management.

4. Fiscal Rules Governing the Sector

The disjuncture between the different versions of the Bill is most significant when it comes to fiscal terms. The most important step that the National Assembly should take before deciding upon the Bill is demanding clarity from the Executive about what it is proposing and fuller disclosure of government projections on revenue collection and investment under its plans, and how these projections differ from those estimated under the current regime. Without having a set of projections to analyze and question, and an understanding of the assumptions behind those projections, the legislature cannot adequately decide upon the Bill or assess oil companies' arguments that the PIB will destroy incentives to invest.

The official version of the PIB envisions a regime in which the major share of the revenue collected by the government (besides dividends to be paid by NNPC, discussed below) is a profits-based tax of 85% of chargeable profits for companies engaged in petroleum operations (50% in deep offshore and inland basins) and 45% for companies engaged in upstream gas (35% for upstream gas in deep-water or Production Sharing Contract areas) (§429).[5] The inter-agency memorandum version proposes the use of a more varied toolkit. In it, companies would pay a Nigerian Hydrocarbons Tax (NHT), which is somewhat similar to the tax suggested in the official version, but which sets the rate at lower levels of 50% of total company profits for onshore/shallow water areas and 30% for frontier/deepwater areas. The memorandum version also establishes a minimum payment of 2% of gross income from upstream operations in the event that the tax on total company profits would not meet that threshold (§§443, 444, 454). The inter-agency memorandum adds a standardized system for collecting royalties, at a rate that varies between 5% and 25% based on average daily production levels, with additional price-based royalties assessed on a sliding scale when the oil price exceeds $70 per barrel or gas price exceeds $2 per million btu (§§434-438). It also explicitly requires companies to pay tax on

[5] Section 429 of the PIB also indicates that, "[w]here a company engaged in petroleum operations has not yet qualified for treatment under paragraph 7(4) of the Tenth Schedule to this Act, its assessable tax for any accounting period during which the company has not fully amortized all pre - production capitalised expenditure due to it less the amount to be retained in the book as provided for in paragraph 7 of the Tenth Schedule to this Act, shall be 65.75 % of the chargeable profit for that period." RWI has not seen the schedules to the Act, and thus cannot fully assess the impact of this provision, which could result in a reduction of the tax the government is able to collect. The Assembly should be sure to review all schedules to the Bill.

profits generated by oil production under the Companies Income Tax Act, which under the current system applies only to profits generated via gas (§432).

Analyzing the differences between the official, profit-tax-driven version of the Bill and the inter-agency memorandum, which features a larger and more standardized royalty, involves making policy choices about the impact of each set of tools. Some argue that royalties should be disfavored since the fact that they are charged on gross production rather than profitability means that they discourage investment in higher-cost or lower-grade fields. These analysts favor fiscal systems in which profit-based instruments predominate, arguing that taxing companies on profits minimizes distortions and aligns company and government interests in maximizing investment. Others argue that developing countries should enact significant royalties, as they are easier to administer, provide greater guarantees of income early in a field's production cycle and are less subject to disputes related to the calculations of allowable costs and taxable income.[6] Nigeria must balance the likelihood that adding a more significant royalty component into the fiscal mix will make collection easier to administer and therefore reduce under-payments against the risk that it may discourage some marginal investment in difficult or less-profitable fields. A review of government revenue projections under both possible systems is crucial for this determination.

While the National Assembly assesses the best mix of fiscal instruments, it should also pay close scrutiny to apparent weaknesses in the official version of the PIB, which could undermine the goals of improving Nigeria's take and standardizing rules across the sector. The Bill would explicitly repeal the Petroleum Profits Tax (PPT) Act and the Deep Offshore and Inland Basin Production Sharing Contracts Act, currently the main pieces of legislation governing revenue generation in joint venture and PSC projects, respectively. However, it does not provide replacements for certain core elements of those Acts. This will be a source of significant confusion at best, and, at worst, could give rise to a significant loss of revenues. Perhaps most notably, while the Bill includes provisions for the deductibility and administrative responsibility for rents and royalties, it does not spell out what royalties are owed or how they are to be calculated. The Bill leaves unclear whether royalties are to be collected according to the current system established by the PPT Act/Memorandum of Understanding OU, or to be excluded as a revenue source. Even if the current collection system remains in place, the PIB fails to provide more clarity on the method for calculating the royalty base—a problem identified in the latest NEITI Financial Audit as a source of discrepancies.[7] NNPC is cast as a taxpayer under the Bill, but as noted above, it says nothing about how the company is to pay dividends. This is a significant oversight since the value of NNPC's sales represented almost half of the Federation's total oil revenue in 2005. If this is not adequately addressed, the PIB could result in major fiscal losses to the government.

By eliminating the dual-track system by which companies have the option to calculate PPT under either the PPT Act or the MOU, the Bill could alleviate some of the confusion and underpayment noted in the NEITI Financial Audit (pp. 25-31). But as the Assembly assesses the new tax

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[6] For a more thorough discussion of the arguments for and against royalties, please see International Council on Mining Metals, *Minerals Taxation Regimes: A Review of Issues and Challenges in their Design and Application*, February 2009, available at http://www.icmm.com/page/12880.

[7] *Nigeria Extractive Industries Transparency Initiative Financial Audit 2005*, available at http://www.neiti.org.ng/2005%20Audit%20Reports/FinancialReport-ConfidentialDraft.pdf.

proposed under the official version of the PIB, it should recall that the stated rates (85%, etc.) are to be imposed on *chargeable profit* assessed at a company-wide level (except for PSCs, in which case profit is assessed at a project level), after allowable deductions of costs and with unlimited carry-forwards of losses from one year to another. The fact that contract areas are not to be ring-fenced for tax-calculation purposes means that a company would be able to offset losses incurred in one contract area from income earned on another, and thus defer payment of taxes (§428). This and other incentives to investment are not necessarily inappropriate, but the Assembly should review the bottom-line revenue projections carefully, rather than being blinded by the tax rates alone.

Two additional revenue-generation tools included in the Bill are poorly defined and require more examination. As discussed above, the provision that the Directorate may itself collect up to 2% of fiscalised crude appears to be susceptible to abuse, and may violate the constitutional requirement that all petroleum revenues be directed to the Federation account for distribution at the federal, state and local levels. Furthermore, the section requiring state governments to pay 1% and local governments 0.5% of their derivation allocations into a remediation fund (§286) fails to describe any procedures for the collection of the revenues or the management of the Fund.

Key Questions and Actions for the Legislature:

- Which fiscal package is the Nigerian executive proposing, and how do the fiscal terms interact with existing legislation?
- The legislature should demand that the Executive share its full assessment of projected revenues under the proposed regime. The Assembly should seek an independent assessment of the government's projections.
- Does a profits-tax-dominated approach or a mixture of taxes and royalties provide Nigeria with the better opportunity to incentivize investment and generate public revenue, given the capacity of the Federal Inland Revenue Service and other key administrative bodies?

5. Transparency Provisions

The PIB contains laudable provisions on transparency. The official version of the Bill mandates that public institutions should be guided by the principles of the Nigerian Extractive Industries Transparency Initiative (NEITI) Act, and that confidentiality clauses that would prevent the disclosure of revenue information are null and void (§259). The memorandum submitted by the inter-agency committee takes this provision even further, requiring the publication of contracts and mandating that companies submit data on their revenues and production costs to be summarized and published on the website of the National Petroleum Directorate (§273).

However, the PIB does leave in place a potentially significant loophole by allowing the Directorate to make a final decision about whether a clause represents a "proprietary industrial property right" that exempts it from the provision (§259(3)). By providing more detail on how the Directorate's determination would be made, or by providing for judicial or administrative appeal, the Bill could provide Nigeria's citizens with a stronger platform for demanding information and would reduce the risk of collusion between companies and the Directorate.

Key Questions and Actions for the Legislature:

- The Assembly should consider including §273 of the inter-agency committee's memorandum in the official Bill, as the publication of contracts and data on production costs represent crucial tools for citizen engagement and the enforcement of rights.
- What improvements can be made to rules regarding exemptions from the no-confidentiality clause policy, so as to ensure that exemptions are granted sparingly and the strong majority of contracts and flows are published?

6. Rules Promoting Environmental Protection and Community Development

Among the biggest problems with the oil industry in Nigeria is the failure of the government and companies to develop adequate mechanisms for protecting the environment from harm and ensuring that communities benefit from production. The official version of the PIB does not provide a systematic approach to improving the status quo. On environmental matters, §283 requires companies to submit an environmental program or environmental quality management plan to the Inspectorate for approval. Companies would also be required to pay a sum to the Inspectorate for site rehabilitation or to correct any environmental damage (§285). These are positive features, but the Bill does not delineate clear guidelines by which the Inspectorate can assess the plans, set or update the cost estimates, or determine the appropriate time to intervene for damage remediation. Some of these details can be elucidated in regulations, but without a clear legal mandate about how the Inspectorate is to make these decisions, Nigeria risks having oil companies dominate the setting of environmental procedures. The Bill provides more extensive details on standards and procedures for decommissioning (§287), but it does not meet with international best practice by requiring that financing be secured for decommissioning ahead of time, via escrow accounts, bonds, insurance, guarantees or some other measure. Nor does it incorporate a cost-benefit analysis that includes environmental considerations into the decision about whether to open a new area for oil activity.

The provisions on consulting communities in oil-producing areas are even more skeletal. The Bill's opening sections commit the federal government to promoting community development and ensuring that the damage to communities is minimal (§§6, 8). But the Bill provides no tangible measures that would give force to this goal, such as mandating community consultations or government oversight of community development plans or social impact assessments. Section 413 of the inter-agency memorandum represents a significant improvement, requiring companies to submit Nigerian content plans and specific social responsibility provisions, covering infrastructure, local employment and contracting, and training, for every license. Even these more substantial provisions stop short of requiring companies to devise their development initiatives in collaboration with host communities, specifying that companies *may* enter into community development agreements (§413(6)) but not requiring it.[8]

Key Questions and Actions for the Legislature:

- If the Bill is to achieve the government's goals of better social and environmental management, it should not leave all of the elaboration of clear standards and

[8] For a more detailed discussion of community engagement techniques, see World Resources Institute, *Breaking Ground: Engaging Communities in Extractive and Infrastructure Projects*, 2009, available at http://pdf.wri.org/breaking_ground_engaging_communities.pdf.

procedures up to regulation. Vis-à-vis the environment, how can the Bill provide clearer standards for the Inspectorate to follow in reviewing company environmental plans and for incorporating environmental costs into decisions about whether to develop an area?

- Regarding social development, should the provisions included in the inter-agency memorandum be included in the official Bill?

7. Ensuring Adequate Work is conducted in Oil Licenses and Contracts

One major source of inefficiency in the Nigerian oil sector has been the award of exploration or exploitation rights to companies that hold onto licenses as assets without investing in field development. The PIB takes some steps to alleviate this problem, but does not address it fully. It mandates that the award of rights be conducted through an open, transparent and competitive process (§270), which is a crucial component of the effort to give operatorship to effective companies and ensure that quality work is done. But the major problem that has beset Nigerian upstream auctions during this decade has been the failure to effectively vet bidders via pre-qualification, resulting in companies with little or no technical or financial capacity winning rights to important areas. The PIB does not need to spell out all of the details for pre-qualification processes, but it would be more effective if it firmly established the requirement for rigorous pre-qualification and listed core criteria on which would-be bidders' eligibility is assessed.

Another important tool for ensuring that small and large oil companies develop Nigeria's fields rather than sitting on them without investing is the establishment of minimum work commitments and government oversight of company work, development and investment plans. The PIB does not require periodic government review and approval of these plans, leaving Nigeria exposed to the schedules of the oil companies, which will be highly dependent on events outside the government's control, such as company strategic priorities, changes in macroeconomic conditions, etc. Again, the inter-agency memorandum version (§§277, 278) provides stronger protections of government interests in the prospecting and development stages, and should be examined by the legislature.

Key Questions and Actions for the Legislature:

- Fixing an appropriate level of government oversight over petroleum companies requires difficult policy judgments. How should the Bill seek to ensure some minimum of control to ensure that companies are investing in the development of Nigeria's assets while avoiding the creation of too many bureaucratic hoops that would damage efficiency?

Conclusion

Accomplishing the goals set out in the PIB—stronger checks and balances, greater transparency, better fiscal benefits for Nigeria, more effective protection from environmental and social harm—would help Nigeria turn the page to a more successful era of petroleum management. But the Bill itself has significant flaws, and risks falling short of its lofty ambitions. Thus the Bill must not be considered static, and the National Assembly should work with other stakeholders to include stronger governance mechanisms, clearer definition of roles, and more clarity about the vision for the generation and management of government revenues.