The Petroleum Industry Bill and the Future of NNPC

By Aaron Sayne, Paasha Mahdavi, Patrick R. P. Heller and Johannes Schreuder

Summary

The 2012 Executive Draft of the Petroleum Industry Bill (2012 PIB) proposes to restructure the Nigerian National Petroleum Corporation (NNPC). This is potentially welcome, yet the bill ultimately fails to offer a clear path to more effective management of Nigeria’s state-owned oil enterprises. Based on comparative analysis of 12 national oil companies (NOCs) and NNPC’s current situation, this brief concludes that the 2012 PIB is unlikely to significantly advance the following four goals.

Goal One: Commercialization

The bill splits NNPC into three companies and creates two new agencies to assume many of the corporation’s current regulatory duties. Such steps could be parts of a strategy for commercializing NNPC, but the bill omits most of the detail needed to actually make the NOCs more profitable and efficient. This creates a high risk that the new institutions would be subject to the same problems of mission creep, mismanagement and weak commercial incentives that have affected NNPC. Specifically, the bill:

- Does almost nothing to define the mandates of the three new proposed NOCs—the National Petroleum Assets Management Corporation (NPAMC), National Gas Company Plc. (NGC), National Oil Company (NNOC). It provides almost no guidance on what being “commercial” should mean for each, or how their responsibilities would be limited.
- Creates substantial confusion about the assets these companies would inherit and how they would participate in the Nigerian petroleum sector in the future.
- Provides for partial privatization of NNOC and NGC, but does not require a minimum level of privatization, does not specify which government agencies will oversee the effort, foregoes the benefits of listing on an international stock exchange, and imposes an arbitrary and potentially costly six-year deadline. The bill does not mandate the partial privatization of NPAMC, which would control nearly all of Nigeria’s current onshore oil production.
- Lacks clear provisions on the shareholding rights of government.
- Contains no transition framework guiding how the NOCs would achieve commercialization.

Goal Two: Sustainable Finance

International experience shows that NOCs need flexible, reliable options for accessing capital while maintaining checks and balances that prevent them from becoming states within the state. Of particular importance is developing a workable revenue retention model that allows the kind of medium- and long-term planning needed for effective commercial operations. The 2012 PIB does not put the three NOCs it creates on a path to sustainable finance. In particular, the bill:

- Does almost nothing to define the mandates of the three new proposed NOCs—the National Petroleum Assets Management Corporation (NPAMC), National Gas Company Plc. (NGC), National Oil Company (NNOC). It provides almost no guidance on what being “commercial” should mean for each, or how their responsibilities would be limited.
- Creates substantial confusion about the assets these companies would inherit and how they would participate in the Nigerian petroleum sector in the future.
- Provides for partial privatization of NNOC and NGC, but does not require a minimum level of privatization, does not specify which government agencies will oversee the effort, foregoes the benefits of listing on an international stock exchange, and imposes an arbitrary and potentially costly six-year deadline. The bill does not mandate the partial privatization of NPAMC, which would control nearly all of Nigeria’s current onshore oil production.
- Lacks clear provisions on the shareholding rights of government.
- Contains no transition framework guiding how the NOCs would achieve commercialization.
Briefing

• Is silent on how NNOC and NGC would fund their operations.
• Allows NPAMC to retain at least some of its own revenues in an unspecified “fund.” This could help ease joint venture funding constraints, but the bill is vague as to how retention would work in practice and includes no management constraints on the fund.
• Does not discuss NOC crude oil sales, which account for up to 70 percent of public revenue. Critically, the bill fails to specify which institution would sell the government’s share of crude or how revenues would reach the Federation Account.
• Fails to define core fiscal terms that could determine the commercial viability of the new NOCs’ upstream operations. These include crude oil and gas royalties, concession rents, bonuses, production sharing, domestic crude oil supply obligations and the survival of contract stabilization clauses. Such an extreme lack of clarity could delay commercialization and have serious negative effects on sector investment and NOC bankability.

Goal Three: Limited Political Interference in Technical Decisions
No provisions in the 2012 PIB are geared directly to reducing unwarranted political interference in NOC operations or finances. High-performing NOCs are led by skilled and independent boards and staffs empowered to make technical and commercial decisions. But the bill does little to alter the status quo, allowing for continued political interference. Specifically, it:

• Does not address the composition of the NNOC or NGC boards, and proposes an NPAMC board heavily dependent on the presidency.
• Exposes the three new NOCs to no direct legislative oversight, though it leaves open the question of the National Assembly’s role in appropriating funds to them.

Goal Four: Transparency and Public Accountability
The 2012 PIB contains useful new public reporting rules that could impact the transparency of the proposed new NOCs, including:

• The upstream regulator will publish lease-by-lease “summary of all revenues and costs,” as well as all licenses, leases, and contracts involving NNOC.
• NPAMC must conduct annual audits to international standards.

The transparency provisions have a number of shortcomings, however, that should be addressed.

• NPAMC and NGC are not subject to the upstream contract-disclosure requirement, which means that joint venture and gas contracts will likely remain opaque.
• The downstream regulator is not required to publish information on downstream activities.
• There are no auditing requirements for NNOC and NGC, and NPAMC is required to publish only a summary of its audited accounts.

No piece of legislation, on its own, can correct all the issues that affect NNPC performance; many details would need to be developed in subsequent regulation and during the transition process. But the PIB fails to lay the groundwork for a successful transition. It carves up NNPC without establishing the basics of what comes next and lacks some basic mechanisms for encouraging performance and accountability.

Introduction
The 2012 Presidential Draft of the Petroleum Industry Bill (2012 PIB) proposes to restructure the Nigerian National Petroleum Corporation (NNPC). This is potentially welcome, yet the bill fails to offer a clear path to more effective management of Nigeria’s state-owned oil enterprises. This brief analyzes the likely impact of the bill’s provisions on four core goals for NNPC reform—
commercialization, sustainable finance, limited political interference, and transparency/accountability—based on reform options identified through comparative analysis of the 12 national oil companies (NOCs) listed in Table 1.

For each of the four core goals, the brief lays out the challenges Nigeria faces today, articulates options that have spurred improvements in the 12 case study countries, and assesses the PIB in light of these options. We conclude that the bill represents a significant missed opportunity. It seeks to create three new entities to control assets currently held by NNPC without clearly delineating the roles or responsibilities of these new bodies. It calls for the partial privatization of some assets but not others without evident justification, and it does not provide guidance on transition provisions. It does little to clarify the chain of responsibility and financing between the state-owned enterprises and the government. On transparency, some of the 2012 PIB’s provisions hold promise for improved NOC governance, but the coverage of the three entities is inconsistent, and several types of disclosure are excluded.

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Goal One: Commercialization

Challenge

Commercialized NOCs think primarily in terms of maximizing profits and controlling costs. The high performers that have achieved this possess clear commercial mandates and develop the structures, autonomy and incentives needed to carry out those mandates.

NNPC’s lack of a clear commercial mandate inhibits strategic planning, increases operating costs and undermines the corporation’s bottom line. Nearly all of its dozen-plus subsidiaries run at a loss. Downstream operations are the biggest cost and debt center, due in large part to poor management, low investment and NNPC’s quasi-fiscal participation in domestic fuel subsidies. Meanwhile conflicting roles lead to suboptimal asset management and conflicts of interest. For instance, in the sale of crude oil to the nation’s four refineries, NNPC acts as regulator, buyer and government commercial agent. NNPC also manages the government’s stake in Nigeria’s oil operations as a parastatal organized under the presidency, rendering it unaccountable to any shareholders in a purely commercial sense.

Options

1) Limit and/or carefully define noncommercial roles: NOCs around the world engage in noncommercial activities, as shown here:
As custodians of government policy and resources, NOCs tend to serve more noncommercial goals than private oil companies. This can further the national interest, but noncommercial activities must be clearly defined and delimited in a government’s strategic outlook for its NOC. Otherwise, the NOC can face a vague and overwhelming set of objectives that steers resources away from focused commercial development. Mexico’s Pemex, for example, directs a program called Donativos y Donaciones (Gifts and Donations), which aims to promote social development by delivering small-scale infrastructure, in-kind goods and cash transfers. The state has not clearly defined Pemex’s role in the program, and administering its many facets has distracted attention from operations.

Whether NOCs should engage in regulatory functions is an especially controversial issue. Strictly limiting them to commercial roles is often touted as the best route to achieving levels of integrity, capacity and innovation needed to commercialize. But research has shown that rigid separation of functions among different petroleum-sector bodies—of which Norway offers the textbook example—is not always advisable or achievable, especially when institutions face serious political and capacity hurdles. Three of the eight top performers in our sample engage in some industry regulation. Petronas and Sonangol in particular retain a strong commercial focus because of the governments’ steady commitments to:

- Clearly delimit NOC roles
- Provide strong, consistent funding for development of NOC skills and capacity
- Empower the NOC to make independent technical decisions
- Allow the NOC to set and pursue its own commercial goals

Petronas also enjoys authority over its own accounting systems and free reign over its overseas operations, allowing the NOC to independently manage revenues from joint ventures abroad. This autonomy has allowed Petronas to maintain impressive profit levels.

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2 Regulatory activities refer to the NOC’s role in soliciting contract tenders, awarding bids and in some cases enforcing resource companies’ compliance with petroleum-related laws. Social development refers to NOCs taking responsibility for managing or funding health, environmental management, education or other social programs. Quasi-fiscal activities include significant outlays by the NOCs for fuel subsidies, large-scale public works projects, national debt servicing or other financial tasks that would typically be undertaken by the state itself.


5 Petrobras also performed a large number of regulatory duties during the period in which the Brazilian oil sector took off, until the creation of an independent regulator in 1997.
Briefing

Some NOCs need significant time to improve their skill sets and bankability before they are ready for strong commercial mandates. Confining such companies to an initially limited range of profit-seeking activities, coupled with some regulatory duties, can help them commercialize successfully over a period of years through encouraging specialization and capacity development. For decades, the Angolan government and Sonangol consciously limited the company's commercial role to selling oil and promoting local content. Officials emphasized Sonangol's quasi-regulatory role as the company honed its skills, then pushed it deeper into commercial ventures—principally through Sonangol’s exploration and production subsidiary—as the company developed sufficient expertise. This phased approach to defining the company’s role has driven Sonangol to economic success, though the Angolan NOC remains characterized by serious shortcomings in public accountability.

Denying regulatory powers to an NOC outright is also an option, the one chosen by top performers such as Statoil and Saudi Aramco. PetroVietnam, a middle performer, operates in an oil sector in which responsibility is highly decentralized: the Ministry of Trade and Industry is responsible for policy, operational and strategy decisions, and some regulation; the Ministry of Planning and Investment handles investment certificate registration and investment capital of oil companies; and the Inspection of Petroleum Operations agency monitors compliance with petroleum regulations. All of these agencies are independent of PetroVietnam, which has helped distinguish it as a commercial player.

Limits on NOC noncommercial activities can be set in law, either in great detail or in more general terms subject to later precise, transparent directives. For partially privatized NOCs, listing activities in a shareholder’s agreement or articles of incorporation might sometimes be more appropriate. The key is to make the list legally and politically binding.

2) Publicly list NOC shares: If managed well, public listings can enforce market discipline. They have encouraged innovation and efficiency in the following three cases:

_Petrobras_: Brazil partially privatized Petrobras in 1997 with the ratification of Law 9.478. At the same time, the state established a regulatory body, the National Petroleum Agency, to guide Petrobras through its transition to a mixed public-private entity, and in particular, to assist in the sales of its shares abroad (notably on the New York Stock Exchange). Proceeds from the sales then went back into the sector, principally in offshore drilling and exploration.

This exercise served Petrobras’s stated goal of increasing revenues in three ways. First and most obvious, the share sales raised cash up front. Second, compliance with stringent U.S. stock exchange reporting requirements incentivized better, more efficient management, which in turn reassured investors when Petrobras went out to raise capital. Third, the share sale helped reduce fuel subsidy costs, which were ballooning Brazil’s public debt and inflation. By creating new and binding obligations to maximize Petrobras’s profits for shareholders, Brazil gave itself a fresh legal argument against entrenched interests around subsidies. Phaseouts were then done gradually to reduce political fallout, with price controls on products with smaller market shares (jet fuel, lubricants and kerosene) reduced ahead of the big gasoline and diesel subsidies. Within a period of years, Petrobras’s production levels, proven reserves and revenues increased substantially, and the

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7 The state currently holds 64 percent of common shares, with voting rights at the company’s shareholder meetings, and 48 percent of Petrobras’s preferred shares, which do not carry voting rights.
8 See Adilson de Oliveira and Tara Laan, “Lessons Learned from Brazil’s Experience with Fossil-Fuel Subsidies and their Reform,” International Institute for Sustainable Development working paper, 2010. Brazil has since reintroduced subsidies, though they are far lower than their pre-2001 levels.
company has further enhanced its skills and reputation as a world leader in deepwater exploration and production.9

Statoil: The Norwegian government partly privatized Statoil in 2001 through listings on the Oslo and New York stock exchanges, retaining 67 percent of shares for itself. The Norwegian Petroleum Directorate, Norway’s principal oil regulator, oversaw the transition process. The state also established a new nonoperating company, Petoro, to manage its direct financial stakes in oil and gas, which are held in a financial portfolio known as the State’s Direct Financial Interest (SDFI).10 The purpose of transferring assets to SDFI, as stated in the country’s oil privatization law, was to lessen Statoil’s control over the sector and state oil money while granting it more commercial freedom.11

Faced with declining offshore production, the Norwegians used privatization to increase their NOC’s efficiency. The reform was ultimately successful: Since 2001, Statoil has showed a marked increase in investment and income.12 From 2001 to 2008, for instance, net income increased from $2.7 billion to more than $7.2 billion.

KMG: In 2006 Kazakhstan listed its NOC’s upstream arm, KMG E&P, on the Kazakh and London stock exchanges. Driving factors included a desire to expose KMG E&P to market pressures, a wider trend of privatizing Kazakh state-owned enterprises, and the need to raise funds for future asset purchases—including 50 percent of KasGerMunai and a one-third interest in PetroKazakhstan.13 The KMG E&P IPO raised more than $2 billion. The strictures of U.K. and Kazakh reporting rules also improved accounting and reporting standards for KMG E&P and its parent, though the company still faces governance challenges affecting its commercial performance.14

3) Improve corporate governance through the discipline of external debt financing: In some cases, sourcing funds from international financial markets encourages commercialization, if not as strongly as privatization. Governance of Pemex derived some benefit from the process of seeking international debt financing, which it began in 2002. The high disclosure standards associated with its foreign bond issues boosted financial accountability to the Mexican government and forced better investment decisions. Burdening an NOC with debt should in no way be seen as the surest road to commercialization. But Pemex deserves credit for its creative solutions to accessing finance and improving governance in a tough political climate.15

4) Define clear shareholder structures and roles: These take two forms in 100 percent state-owned NOCs. Under the first, a strong, single, state shareholder makes major policy decisions but leaves operations management to the NOC. Examples of this model include:

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9 Agency data indicates that Petrobras currently produces 1.9 million barrels per day, up an average of 10.4 percent per year since 1997. Proven reserves in the same period doubled from 73 billion barrels to 142 billion barrels. Government revenues from exploration and production have climbed steadily from $0.3 billion in 1998 to more than $9 billion in 2007. See Adilson de Oliveira, “Brazil’s Petrobras: Strategy and Performance,” in David G. Victor, David Hults and Mark C. Thurber (eds.), Oil and Governance (Cambridge: Cambridge University Press, 2012), 544.

10 The SDI interests in oil and gas projects are separate from Statoil’s equity shares in those projects.


12 Production levels have fallen from 3.4 million barrels per day in 2001 to 2.1 million barrels per day in 2010; similarly proven reserves have decreased from 116.6 billion barrels in 2001 to 6.7 billion barrels in 2010.

13 Martha Brill Olcott, Kazmunaigaz: Kazakhstan’s National Oil and Gas Company. (Houston: James A. Baker III Institute for Public Policy of Rice University, March 2007).

14 In particular, KMG faces challenges in meeting its capital commitments to the giant Kashagan project. Anthony Lobo and Valérie Marcel, The National Oil Company Investment Challenge, (KPMG, 2010).

15 For more detail, see Lobo and Marcel. Note also that Pemex also underwent fiscal reforms in 2006 that have so far been successful. The reforms aimed to reduce the company’s tax burden to the state from 80 percent in 2006 to 74 percent by 2008 to 71.2 percent by the end of 2012. These fiscal changes have resulted in a moderate improvement of Pemex’s financial performance, allowing the company to open funds for reinvestment and debt reduction, and more importantly, to return to profitability in the near future. See Ognen Stojanovski, “The Void of Governance: An Assessment of Pemex’s Performance and Strategy,” in David G. Victor, David Hults and Mark C. Thurber (eds.), Oil and Governance, 301.
• *Petronas*: Under Malaysia’s 1974 Petroleum Development Act, the prime minister’s office, as sole shareholder in Petronas, collects annual dividends and taxes from the NOC.¹⁶

• *Aramco*: The monarch exercises shareholder powers through the SCPMA council, which oversees the Petroleum Ministry. This gives the king indirect power over major policy decisions, including OPEC action, production volumes and spare capacity levels.¹⁷

• *KMG*: Kazakhstan’s state wealth fund holds all KMG shares but exercises limited oversight of operations. The clear, unified direction of this model greatly benefited the IPO of KMG E&P by promoting a smooth transition to semiprivate ownership.

The second model splits ownership across different agencies without clearly defining the roles of each. In the case of Iran, the government owns 100 percent of NIOC, yet voting rights for the NOC are shared among the legislative and executive branches, the unelected upper tier of government, and various regulatory agencies. Pemex is similar, with president and legislature competing for decision-making power. Dividing roles and powers theoretically creates useful checks and balances. But without a clear definition of roles, division in practice risks paralyzing the NOC operationally and politicizing reform.

5) **Develop a detailed, achievable transition framework**: Finally, some enforceable document should lay out key processes, triggers, and roles for how a reforming NOC “transitions” from its current state to commercialization. Triggers can be based on time (the NOC must list some number of its shares within a certain period of time) or performance (the NOC can list after an internal restructuring, after selling off certain subsidiaries, or once its balance sheet liabilities decline by 40 percent). Privatization in particular must happen at a time when investors see the NOC as an attractive risk. Implementing a sound transition framework can help it reach that point more quickly and reliably.

**PIB Analysis**

The 2012 PIB does not provide a well-developed approach to commercializing NNPC. The bill breaks NNPC into three new and separate companies. But very little in the bill suggests why this complex, confusing move is an appropriate or necessary structure for improving Nigeria’s public oil sector management. Specifically, the bill creates:

• The National Petroleum Assets Management Corp. (NPAMC, which would initially manage NNPC’s interests in its six unincorporated joint ventures and thereafter “any upstream asset as the Government may from time to time deem fit” (Section 125).

• The National Gas Co. PLC (NGC, which would receive the assets of the Nigerian Gas Co. (163).¹⁸

• NNOC, which after incorporation would receive the NNPC assets and liabilities not otherwise vested in the first two entities (152).

The 2012 PIB does almost nothing to define the mandates of these three new NOCs. It creates new regulatory bodies—the Upstream Petroleum Inspectorate and the Downstream Petroleum Regulatory Agency—to assume many of NNPC’s current regulatory functions. The empowerment of these bodies could contribute to a reduction in conflicts of interest in the sector and the evolution of more commercially focused NOCs. But the practical unbundling of institutional roles in Nigeria is exceedingly complex, and without a clearer definition of the companies’ goals and responsibilities, the risk of a continuation of the regulatory confusion that has befallen the Department of Petroleum Resources and NNPC is high. Furthermore, the creation of a separate

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¹⁶ The act can be found at http://www.agc.gov.my/Akta/Vol.%203/Act%20144.pdf.


¹⁸ There appears to be a drafting error in Section 163, which reads that “the assets and liabilities held by NNPC on behalf of the Federal Government of Nigeria except Nigeria Gas Company Plc shall be vested in the National Gas Company Plc” (emphasis added).
gas company does not unbundle crude oil and gas production in operational terms, since most of Nigeria’s gas is associated, meaning it is extracted from the same reservoirs as oil.

NPAMC’s one listed function is extremely vague: “to acquire and manage investments of the Government in the Nigerian upstream petroleum industry” (120). No functions for NNOC or NGC are listed at all. Instead, the bill allows these to be dictated by the new companies’ memoranda and articles of incorporation (156, 167), which the petroleum minister is charged with creating (148, 159). Inferring mandates from the assets assigned to each entity is also difficult because beyond the initial vesting of onshore assets in NPAMC and of gas assets in NGC, the exact division of additional assets only happens one to two years after the bill becomes law (125, 152, 163).

How future NOC interests will be handled is also unclear. Notably, the bill grants the government an optional “right of participation” in future upstream licenses and leases (192). But it nowhere says what form such a right would take, which entity would own and directly benefit from it, and only names the petroleum minister as the party to “exercise” it (192). How the three companies might relate to one other commercially and financially is also not addressed. The lack of clarity could have a serious chilling effect on future investment—the exact opposite of what the bill aims to achieve. Past comparative research also suggests that the level and nature of an NOC’s participation in operations influences what sort of outside oversight it needs to perform well.

The 2012 PIB takes small steps toward partial privatization but lacks a coherent underlying vision. The bill would require the federal government to sell up to 30 percent of NNOC shares and up to 49 percent of NGC shares on the Nigerian Stock Exchange within six years of their incorporation (151, 162). There is no minimum required divestment. There is no required divestment of NPAMC (some language suggests certain NPAMC subsidiaries would also have the option of privatizing, but this is not clear), thus the company set to inherit the country’s large joint venture assets appears least likely to undergo the kind of ownership changes that could bring about a more commercial, high-performing management system.

Several other major questions related to the privatization remain unanswered. For instance, which government body would decide timing, price, or terms and conditions for the share sales, and how? Why is the Bureau of Public Enterprises apparently excluded from the privatization process (360)? Will any shares be set aside for management or staff? The six-year cut off for listing appears potentially costly: would NNPC’s successors be ready to go public successfully in such a short period of time? Could it show improvements in operational and financial standings sufficient to attract premium prices? Limiting public offers to Nigeria’s small stock exchange is also questionable: why forego the greater discipline and subscriber base international listings can offer? And why close off the option of raising capital through share sales after six years?

The new institutions’ abilities to raise external debt financing are discussed in Goal Three.

19 NNOC, for instance, would probably receive all existing production-sharing contracts and NNPC’s interests in its remaining dozen-odd subsidiaries, including PPMC, the various crude trading companies, NPDC, NETCO, etc., and NNPC’s 49 percent interest in Nigeria Liquified Natural Gas (NLNG). For each entity, “assets” is defined generically to include “all bonds, loans, financing arrangements, joint operating agreements, sole risk agreements, hypothecations, securities, deeds, contracts, instruments, documents and working arrangements” (125(5), 152(4), 163(4)).

20 Options include joint ventures with NOC equity participation (the bill does not specify how levels of equity participation would be determined); PSCs with an NOC as a party; and service contracts executed between an NOC and one or more private companies, or between an NOC and some government body. Other open issues for government participation include whether the government would have a right of first refusal over some or all licenses and leases, or whether it would enjoy other powers of oversight and approval that arguably constitute “participation” (for instance, determination of operatorship, voting rights on operational decisions, and mandatory inclusion of sole risk provisions in contracts).

The bill also does little to clarify shareholder rights and responsibilities. Under the bill, “a nominee of the Petroleum Ministry and Ministry of Finance Incorporated” will hold all shares in NNOC and NGC until they are partly privatized (150, 161). NNOC will control 99 percent of its own shares, with the remaining 1 percent held “in trust” by the Petroleum Ministry’s permanent secretary. Unlike prior drafts, the 2012 bill says nothing about shareholder rights, duties or responsibilities, or how these will be exercised. This would be at least somewhat defensible for NNOC and NGC, whose rules would be established in advance of the possible partial privatization, but what rights will the government’s appointed representatives have until then? Earlier versions also gave the Bureau of Public Enterprises shares in NNOC and NPAMC—arguably a more politically and legally appropriate choice.

How much detail on transition and privatization should be enshrined in law will vary by country. Not all of the issues identified above need to be addressed within the PIB itself. Transitional arrangements may be set out in general sector legislation (Brazil) or special acts governing NOC privatization (Norway). Parts of Nigeria’s own 2005 Electric Power Sector Reform Act could provide a useful model. Details could also come through ministerial directives, incorporation papers or corporate resolutions, assuming such options are politically advisable.

Nonetheless, a PIB that purports to commercialize NNPC without setting forth any detailed transition provisions will have little chance of substantially improving NNPC performance. Yet on this critical issue, the 2012 bill says only that the petroleum minister may send the NNPC board “directions in writing to ensure proper transfer of the assets and liabilities of NNPC” to the three new companies (128, 355(5)). Such an arrangement runs the risk of being captured and politicized.

Whether detailed PIB provisions are needed at all to commercialize NNPC is at least debatable. Another possible starting point would be to sell off the corporation’s underperforming assets—already provided for in the 1999 Public Enterprises Privatisation and Commercialisation Act—and scrap unprofitable subsidiaries prior to incorporation. This brief takes no position on what would be the best model. But there is little to recommend the incomplete model offered by the 2012 PIB, which simply carves up NNPC while providing almost no clarity on what the new companies are expected to do, what assets they will hold, and how they will be managed.

Goal Two: Sustainable Finance

Challenge

Faced with heavy up-front capital expenditures and average project lead times of seven to fifteen years, NOCs need flexible, reliable options for accessing capital. This would allow them to pursue forward-looking strategies and to avoid excessive debt.

NNPC operates without detailed rules for collecting, managing or investing its revenues. At the policy level, Constitution Section 162 arguably contradicts the 1977 NNPC Act and later amendments, which broadly allow the corporation to retain earnings to fund its operations. In practice, NNPC withholds large sums each year—mainly from sales of crude oil and gas—to finance its subsidiaries on an as-needed basis. This lack of a clear corporate finance mechanism, together with NNPC’s status as an unincorporated, low-performing, debt-burdened parastatal, leaves it unable to source third-party financing for its share of sector costs. Financing from international oil company partners helps bridge the gap at high costs to the nation.

The absence of a strong legal or policy framework governing NNPC’s financial relationship to the state undermines returns on both sides. NNPC is not fully subject to the fiscal framework of royalties, rents and taxes that private operators face. Government, in turn, provides the corporation with insufficient funding, whether through the budget process or elsewhere.
Briefing

Options

1) Develop a workable revenue retention model: Access to predictable revenue streams is critical to planning and sustaining commercialized operations. Like NNPC, the other two surveyed NOCs—Pemex and Petronas—that do not retain earnings sufficient to cover their operational costs lose significant profits as a result. Petronas in particular, which has in recent years been able to retain roughly 21 percent of total earnings for E&P reinvestment, has seen its production capacity challenged by ever-higher transfers of profits to the Malaysian government. As of 2009, NOCs globally retained an average 70 percent of their earnings.22

Various models exist, including:

- Retaining a percentage of certain revenue streams (Pemex, 40 percent of service contracts)
- Retaining a percentage of all revenues (PetroVietnam, 50 percent of dividends and royalties, 70 percent of fees)
- Retaining a percentage of total profits (Aramco, 7 percent)
- Retaining dividends (SNH, GNPC)24
- Retaining crude and gas sale earnings on an as-needed basis (NNPC currently)

2) Limit reliance on unpredictable budgetary allocations: Use of the state budget process to finance NOC operations is not inherently problematic. But to ensure sustainable operations, appropriations must be sufficient, timely and predictable. In most cases, they should also not be the NOC’s sole revenue source.25

3) Issuing external debt: Four of the NOCs surveyed—Pemex, Petrobras, Petronas and Statoil—can sell bonds in the international financial market.26 All of the four except Pemex are top performers. Bond sales grant NOCs more flexibility for expansion and working capital purposes. Petronas in particular used 2002 and 2009 sales of 10-year bonds to finance much of its capital expenditure for exploration and production over the 2000s.

4) Fully define the NOC’s fiscal obligations to the state: Clear rules governing financial transfers between the company and the treasury are also needed, to allow for sound financial planning and to avoid the counter-situation where the NOC exercises too much control over state revenues.

PIB Analysis

The 2012 PIB does not include firm steps to put the three NOCs it creates on a path to sustainable finance. The bill is silent on how NNOC and NGC would fund their operations, even though the current joint venture financing problems were an initial motive behind the PIB. Presumably they would retain some unknown portion of revenues they generate, while NPAMC would hold back “such monies . . . as it receives in the course of operations” in an unspecified “fund” (121). This latter provision could help ease chronic joint venture funding constraints. But whether “such monies” refers to revenues or profits, and in what amounts, is not spelled out, nor are any management constraints placed on the fund. According to the bill, NPAMC’s retained earnings would also be supplemented by “such sums as may be made available by the Government” to help defray costs

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22 Leslie Lopez, “Petronas: reconciling tensions between company and state,” in David G. Victor, David Hults and Mark C. Thurber (eds.), Oil and Governance, 834. The authors thank Valérie Marcel for clarifying this point.

23 Note that the company pays out its operating costs after paying royalties and before paying dividends. See Valérie Marcel, Oil Titans: National Oil Companies in the Middle East and North Africa, 135-36.

24 SNH also retains revenues to pay off operation costs, though it must pay all profits to the state.

25 NNOC, for example, receives state funds for gas reinjections into its aging onshore fields and retains earnings from crude sales of equity shares in its buyback contracts. These funds have not been timely and reliable in the past, given the volatility of budget allocations to NNOC in Iran’s five-year development plans. See Central Bank of the Islamic Republic of Iran’s 2009-10 Annual Review (Tehran: Islamic Republic of Iran Public Relations Department).

26 Qatar Petroleum and various Chinese NOCs not covered by this study have also held successful bond sales.
(121). This could mean annual budgetary allocations, though again the text is not explicit and government-backed loans are another option. Some language suggests government funding would cease after two years (122), for reasons unknown. The bill does not say whether appropriations to NNOC or NGC would continue after it becomes law—a critical omission, since some years will likely pass before either entity can source affordable loans or access capital markets.

The 2012 PIB neither prohibits nor substantially helps NPAMC, NNOC or NGC source capital through external debt issues. NPAMC is allowed to borrow externally or from its subsidiaries, though the president has broad veto powers without clear justification (130). The bill does not treat NNOC or NGC borrowing. Because the new companies would also split existing NNPC liabilities (125, 152, 163), all are likely to begin life burdened by significant debts, notably in joint venture cash calls, fuel import costs, intercompany loans and unfunded pensions.

The PIB further muddies the three companies' financial prospects by failing to define fully their fiscal obligations to the state. Most notably, the text is silent on NNPC crude oil sales, which account for up to 70 percent of public revenue. No provisions explain which institution will sell the government's share of crude once the PIB passes, how that share will be determined, or how revenues will reach the Federation Account. As a partly privatized entity, NNOC could be expected to pay government dividends out of oil and gas sale profits. Such a policy is not stated expressly, though, as once again the details are left to incorporation papers.

Unaccountably, the bill also fails to set other core fiscal terms that could determine whether the upstream operations of all three NOCs are commercially viable. For new and renewed licenses, it allows the minister to fix concession rents, crude oil and gas royalty rates, production sharing and other relevant terms under later regulations (185, 197). As a stopgap, it delays the repeal of existing statutory terms until such regulations issue (354). But critically, the bill also sidesteps the issue of whether fiscal terms in existing contracts will survive, including whether stability clauses will be honored. This opens the door to abuses of negotiating powers, unintended fiscal shocks and prolonged litigation.

The 2012 PIB is likewise blank on other key terms with potentially sharp fiscal consequences for the NOCs and the national treasury. These include domestic crude oil and infrastructure supply obligations, cost recovery limits under PSCs, contracting models for use on future projects, and work program guarantees. All “companies engaged in upstream petroleum operations” are required to pay Nigerian Hydrocarbon Tax (299(1), 362), but it is unclear which of three new NOCs would be subject on that basis. NPAMC is made permanently exempt from corporate income tax but subject to other taxes and charges so long as “every company liable to tax under the Part VIII of this Act is also liable for such payment” (142). And apart from a single production allowance (Fifth Schedule, paragraphs 1 and 2), the bill ultimately draws no clear distinctions between fiscals for crude oil, gas, condensate or other oil equivalents. If one assumes the new NOCs will be subject to the same fiscal terms as private upstream companies—which the 2012 PIB nowhere contradicts—such an extreme lack of clarity, while it may ease the bill’s passage into law, could delay commercialization and have serious long-term negative effects on sector investment and NOC bankability.

Importantly, the 2012 PIB deletes the controversial and steep production and price-based sliding scale royalty found in past drafts that investors argued would discourage investment (cite provision from 2009 PIB). It is not clear, however, that the government will not try to reintroduce this term at a later stage.

Elsewhere the bill mentions royalty rates as a bid parameter for future license awards (190(2)). This introduces further confusion as to whether effective royalty rates will be legislated or negotiated. The latter potentially risks trapping investment: Nigeria has had significant problems with overbidding in prior licensing rounds, particularly in its 2005 bidding auction, when dozens of investors bid rates that were too steep to attract bank financing for exploration and development. This led to mass default on awards and high levels of undeveloped acreage.

For taxation purposes, all three companies also enjoy “most favored company clauses” that could cost Nigeria significant tax revenues without clear upsides (123(3), 157(3), 168(2)).
**Briefing**

**Goal Three: Limited Political Interference in Technical Decisions**

**Challenge**

States that depend heavily on oil revenues face a critical dilemma in managing their NOCs. Professional, independent management and boards, not politicians, make key business decisions in the highest performers. This allows for predictable planning, supports the exercise of sound business judgment, and avoids capture by narrow political interests. Yet at the same time, governments retain enough involvement to ensure that their nations’ public resources are being managed effectively and with integrity.

All NOCs, even high performers, are subject to some state interference. As noted above, Petronas is highly beholden to the prime minister, whose power is subject to limited checks and balances. The minister has historically used Petronas as a patronage vehicle, sometimes at the risk of compromising financial and technical performance. During the Lula administration (2003-2010), Petrobras was particularly subject to government pressure at the board level for expenditure in noncore areas. Today, Petrobras again faces political intervention in light of the government’s decision to mandate Petrobras operatorship and a minimum 30 percent equity stake in all blocs in the pre-salt areas.

That said, political interference is highest in the lowest-performing NOCs. Companies such as NIOC and SNH are subject to state interference in profit reinvestment, financing decisions and corporate governance. For example, in 2005 the Iranian executive, under President Ahmadinejad’s so-called “purge of the oil mafia,” substantially revamped NIOC’s organizational structure, replacing ministers, managing directors and even mid-level bureaucrats. Despite requirements for legislative approval of such actions, political interference in the NOC went largely unchecked due to weak de facto constraints on the executive. What ultimately seems to separate the high performers is greater autonomy in making commercial decisions and formulating operational strategy.

Striking a balance between technical independence and broad internal accountability is challenging. Beyond commercial and operational decisions, granting NOCs high autonomy in developing national oil-sector strategies and particularly in revenue management is risky in states in which the economy depends heavily on oil revenues. Unaccountable NOCs in such places can become a “state within a state” ultimately taking control of the formal state’s budget. In Angola, where Sonangol has de facto authority to retain control of huge revenue flows, the IMF uncovered a discrepancy in state accounts of almost $32 billion between 2007 and 2010 (equivalent to one fourth of annual GDP). Quasi-fiscal activities by Sonangol that bypassed the state treasury accounted for most of the discrepancy.

Political interference is arguably the greatest challenge NNPC faces. In practice the presidency has high influence over operational decisions and fiscal matters. Rapid turnover of political appointees—notably six group managing directors in seven years—undermines strategic continuity and encourages politicized decision-making. The petroleum minister chairs NNPC’s board, which is staffed mainly by various business unit managers. Many of the subsidiaries have no functioning boards, or their boards do not meet regularly. KPMG’s 2011 review of NNPC operations also found billions of naira in payments to third parties on the government’s behalf, many bearing no rational relationship to NOC operations.

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30 Paasha Mahdavi, “Oil, monarchy, revolution, and theocracy: a study on the National Iranian Oil Company,” in David G. Victor, David Hults and Mark C. Thurber (eds.), Oil and Governance.

31 The risks are somewhat reduced in countries such as Norway and Malaysia, which enjoy low oil revenue dependence.
Options

1) Choose an appropriate level of legislative oversight: Parliamentary bodies intervene in the operations and financial decisions of many of the NOCs surveyed. Vehicles for this oversight include:

- Statutorily mandated hearings on NOC audited reports
- Required parliamentary approval of contracts and licenses
- Committee reviews and approvals of NOC budgets on a multiyear basis. It should be noted that high-performers Statoil, Petronas and Saudi Aramco avoid this.

Some parliaments—Norway’s, for instance—review the NOC’s financial reports but not business decisions. Under Norway’s Petroleum Act, Statoil must only report to the legislature or the executive on projects with significant economic and social impacts, or costs exceeding $840 million. Overall, post-hoc mechanisms for monitoring the performance of NOCs, including audits and parliamentary reviews, have proven to be more effective drivers of performance than decentralized decision-making or a surplus of required approvals.

2) Invest in NOC staff integrity and capacity: Improving the competence and incentives of staff can also safeguard against narrow, politicized decision-making. Executive appointments to Petronas follow the Malaysian Code on Corporate Governance, which codifies best practices and principles of good governance and sets out mandatory training requirements for directors of private and state-owned Malaysian enterprises.

3) Empower professional, independent boards: The boards of most high-performing NOCs have competent, politically autonomous members who are appointed through open, competitive processes. Options include:

- Appointment by the executive (9 out of 12 NOCs surveyed)
- Appointment by the executive, with legislative confirmation (NIOC and Petrobras)
- Appointment by the industry regulator and NOC employees (Statoil)
- Splitting appointment powers between government and private shareholders (Petrobras)

Board members also should be chosen based on their technical expertise rather than patronage concerns. Appointments from outside the NOC can help capture the right skill sets, with successful precedents including:

- Appointing 6 of 13 members from leading resource, legal and consulting companies (Petronas)
- Appointing a mix of NOC staff and non-national IOC experts (Aramco)

Finally, while appointing ministers to NOC boards is common, doing so can impede effective decision-making, as they often are not fully independent and may not have the time or the specific

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32 Five other NOCs surveyed submit periodic reports and data to legislators, but in practice these are not subject to rigorous scrutiny.
33 This is not the case for Mexico, where Congress does not have an oversight role in contracts and licenses. This is an area in which the executive branch has more authority over Pemex decisions. See Stojanovski.
34 Both Sonangol and Petronas share budgets with their legislatures, but budgetary approval is not legally required. The Malaysian legislative approval process is subject to veto by the executive. See Lopez and Patrick Heller, “Angola’s Sonangol: dexterous right hand of the state,” in David G. Victor, David Huhts and Mark C. Thurber (eds.), Oil and Governance. Saudi Aramco does not give its budgets to the Shura Council; only the executive reviews the company’s budgets. See Valérie Marcel, Oil Titans: National Oil Companies in the Middle East and North Africa.
35 David Huhts, “Hybrid Governance: State Management of National Oil Companies,” in David G. Victor, David Huhts and Mark C. Thurber (eds.), Oil and Governance.
37 The government appoints the majority of board members of Petrobras, while private shareholders nominate a minority of members.
technical skills necessary to conduct vigorous oversight. Past comparative research also suggests that new NOCs facing serious political and capacity hurdles perform better when decision-making authority is concentrated within the NOC itself, rather than in the hands of other administrative figures such as ministers. At the same time, of course, too much concentration of power can leave the NOC unaccountable.

4) Develop institutional checks against interference: Institutional design can also create barriers against excessive interference. In Saudi Arabia the use of a petroleum council allows for more informed, expert-driven policy, while limiting direct executive involvement in NOC-related policy-making.

**PIB Analysis**

No provisions in the 2012 PIB would seem directly geared to reducing unwarranted political interference in NOC operations or finances. Perhaps most critically, the bill ring-fences the government’s onshore joint venture interests—arguably its most valuable active petroleum sector assets—inside a 100 percent state-owned management company dependent on government funding in which the petroleum minister chairs the board of directors and the president arguably can hire, fire and replace four out of five board members (131(2)(a), 135, 137). How this differs substantially from the status quo is not evident. Granted, two NPAMC board members must be nongovernment officials with “substantial corporate experience and professional accomplishment for the private sector.” But no particular competence in oil and gas are required, and the presidency also controls these seats (131(2)(d)). The bill says nothing about NNOC or NGC board composition, and requires only that both be “managed on the basis of” their incorporation papers and “subject to the Governance Rules” of the Nigerian SEC (156, 167).

The bill exposes the three new NOCs to no direct legislative oversight, assuming the National Assembly does not continue to appropriate funds for them. No specific provisions are made for strengthening staff integrity and capacity, though the PIB is arguably not the proper place for this and NNPC already invests deeply in institutional transformation programs. Finally, the bill contains no other concrete, new institutional checks that would limit political interference in NOC operations.

**Goal Four: Transparency and Public Accountability**

**Challenge**

Mandatory performance reviews, whether in the form of audits or other public reporting, can enforce critical discipline that enhances NOC performance. Public reporting is particularly important in states like Nigeria where government institutions face capacity constraints and risks of elite capture.

NNPC discloses very little about its finances and operations: only PetroVietnam and Iran’s NIOC scored lower on our assessment of NOC transparency. Budgets and audits are treated as state secrets, as are information about subsidiary earnings and financial transfers between NNPC and the government. Even though more than half of public revenues flow through the corporation, the National Assembly and Auditor-General of the Federation claim they struggle to get full information from NNPC, as do the other agencies charged with overseeing oil revenue management. No strong legal or policy framework forces NNPC to share information with other stakeholders, and its corporate culture may encourage secrecy.

38 See Lahn et al. for more detail on good governance relating to NOC boards.
39 Heller and Marcel.
40 It should be noted that the Supreme Petroleum Council’s representatives are appointed by the king. See Lahn et al.
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Options

1) **Strengthen public reporting:** Three of the five high-performing NOCs disclose detailed reports of their finances and operations. Relevant information for publication includes:

- Revenue streams under the NOC's control
- Financial balances within the public sector balance
- Spending and earnings projections
- Explanations of the NOC's revenue management framework
- Copies of contracts and licenses
- Reserve and production data, along with future production estimates
- Disaggregated payments to government
- Profit and loss data
- Summaries of E&P activities

Of the six surveyed NOCs that keep such information secret—GNPC, NIOC, NNPC, PetroVietnam, Aramco and SNH—only Aramco is high performing. While there is little transparency in reporting revenues to the public, Aramco maintains tight formal ties to a unified state that importantly gives its NOC insulation from political wrangling. (The king does not, as noted above, interfere with Aramco's daily operations.) In places like Nigeria where power is more decentralized, a public accountability check on the NOC is more necessary.

2) **Publish quality financial audits:** All 12 NOCs surveyed submit either to internal or external audits, with only three—NIOC, GNPC and Petronas—opening their books solely to state auditors. Best practices here include:

- Having external, independent audit firms conduct audits (9 out of 12)
- Publishing audit reports (of the nine externally audited firms, all but NNPC, PetroVietnam and Aramco)
- Hiring auditors through open tenders (all but NNPC)
- Changing auditors periodically (a statutory requirement for Pemex every four to five years, which to some extent has boosted investor confidence for bond issues)

During the 1990s NIOC, Pemex, Petrobras, Petronas and SNH all adopted more transparent reporting practices. In many cases, this improved transparency has significantly boosted the financial goals of NOCs, both by incentivizing better management practices and attracting external investment. Increased financial openness—specifically through publishing data on CAPEX, net operating income, earnings, debts and assets—helped Petronas boost investor confidence for more than $19 billion in bond issues between 1993 and 2010. The bonds, in turn, helped finance major long-term performance improvements.

Not every ostensibly pro-transparency NOC initiative yields dividends. Cameroon attempted to bolster annual outside audits of SNH by signing up to the Extractive Industries Transparency

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41 Public reporting is not the sole contributor to technical success. Despite its transparent reporting practices, Pemex is perceived as a poor technical performer, while Saudi Aramco—perhaps the most opaque NOC in this study’s sample—is one of the best performers. Though some companies achieve technical success in spite of weak public reporting, it can have damaging effects on public accountability. Sonangol has generated large revenues with very weak public reporting, contributing to weak public management, large-scale accounting discrepancies and poor contributions of oil to development.

42 Sonangol’s statements are audited by an external audit organization, but audits are not “signed” by the auditor, meaning that the audit agency cannot confirm that the information provided was up to international standards. This is also the case for PetroVietnam’s externally audited financial reports.

43 Lopez.
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Initiative (EITI). But a lack of political will and poor data quality resulted in the release of reports that provided little useful information. Critically, Cameroon never agreed to a full audit of all oil revenues, allowing extra-budgetary transfers in SNH to continue. Iran’s NIOC stopped publishing audit reports and other relevant data in 2005. This coincided with stagnant production levels and the inability to maintain stable partnerships, particularly in offshore development.

PIB Analysis
The 2012 PIB is uneven in its treatment to transparency. The bill subjects NPAMC, NNOC or NGC to some useful and positive new public reporting rules, mainly for the upstream sector. The new upstream regulator must publish copies of all licenses, leases or contracts involving NNOC on its website, and it must fine companies $10,000 per day for not providing it with such copies (174(6)-(7)). The bill voids confidentiality clauses respecting “payments of royalties, fees, bonuses, and taxes,” though only in “upstream petroleum operations” contracts (174(1-3)). The regulator must also publish lease-by-lease “summartheses of all revenues and costs” on its website (174(5)). The downstream regulator by contrast can but is not required to publish information on downstream activities (45(h), 46(d)). A newly created registry will provide the public copies of downstream licenses on request, for an unspecified fee (213, 217).

However, the PIB also has serious shortcomings and missed opportunities, and there are unexplained inconsistencies in the treatment of the three new companies. NPAMC and NGC are not subject to the upstream contract-disclosure requirement, which means that joint venture and gas contracts will likely remain opaque.

NPAMC must conduct annual audits within six months of a financial year’s close. The audits must be done “in accordance with International Financial Reporting Standards;” and the Auditor-General of the Federation is empowered to approve the auditors (140). The 2012 bill also requires midyear and annual reports, but only the petroleum minister must receive full copies. NPAMC has to post “summaries” of its audit and annual report online, content unspecified (141). This could be easily strengthened by explicitly requiring external audits, the publication of full reports, and the selection of auditors through open tender.

NNOC and NGC are not required to conduct or publish audits, nor furnish any reports. Given the valuable public assets they will inherit, this represents an oversight.

All three companies are exempt (124, 149, 160) from legislation that enforces public sector transparency: the Fiscal Responsibility Act and the Public Procurement Act. The PIB must therefore set its own strong reporting standards. At a minimum, the bill should require all three companies to publish their annual financial and operational reports and external audit reports. The most commercialized companies in the NOC sample—Statoil, KazMunayGas, Pemex and Petrobras—all follow these practices, indicating that transparency will not undermine commercial viability.

44 The president signed a decree in 2005 that increased the budget allocation to the ministries/government entities that relied most on cash advances from SNH. The aim of this degree was to reduce SNH expenditure and to allow for more money to flow to the government via the more transparent regular budget process. The audits and the reduction of extra budgetary expenditures were driven by outside pressure from the IMF and World Bank (in order to receive financial support and debt restructuring). For more detail, see Stepane Cossé, “Strengthening Transparency in the Oil Sector in Cameroon: Why Does It Matter?” IMF policy discussion paper (2006).
45 See EITI website: http://eiti.org/Cameroon. The reports were only able to reconcile unaudited revenue and payment data, weakening the validity of the outcomes. Extra-budgetary transfers in SNH also continued free from scrutiny
47 During this period, NIOC has been subject to stronger international sanctions and the aforementioned political shakeup of the company’s management by Ahmadinejad, both of which have also impacted the company’s technical and operational performance. See Mahdavi.
Conclusion
Increasing the performance of Nigeria’s national oil company constitutes a leading objective of the PIB. Since its first introduction to the National Assembly in 2008, policymakers and commentators alike have frankly acknowledged the confusion, inefficiency and dysfunction that characterize NNPC’s role and activities in the sector. The 2012 PIB falls short in its effort to remedy these problems.

Regardless of the language in the bill, the future performance of Nigeria’s national oil company will depend on the integrity and coherence of the transition process and subsequent operations. No legal safeguards, for instance, can protect an NOC from political interference by a determined executive. However, new sector legislation offers an unparalleled opportunity to lay the foundation for a high-performing national oil company. The 2012 PIB misses this opportunity. It carves up NNPC without establishing the basics of what comes next and lacks some basic mechanisms for encouraging performance and accountability.