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THE PETROLEUM INDUSTRY ACT, 2021: A RADICAL DEPARTURE FROM PAST NORMS

Introduction

On Monday, 16th August 2021, President Muhammadu Buhari signed into law the much-awaited Petroleum Industry Bill, now Petroleum Industry Act (**PIA**), potentially setting the stage for significant changes in the Nigerian oil and gas industry. Prior to PIA, there were different versions of the Petroleum Industry Bill. It started as an omnibus bill and was later divided into 4 separate bills before emerging in 2020 as a consolidated bill.

The PIA amends the provisions of the Pre-Shipment Inspection of Oil Export Act, 1996, and Petroleum Equalisation Fund; and effectively repeals Associated Gas Reinjection Act, and its amendments; Hydrocarbon Oil Refineries Act; Motor Spirits (Returns) Act; Nigerian National Petroleum Corporation (Projects) Act; Nigerian National Petroleum Corporation Act; Petroleum Products Pricing Regulatory Agency (Establishment) Act 2003; Petroleum Equalisation Fund (Management Board, etc.) Act, 1975; Petroleum Profit Tax Act; and Deep Offshore and Inland Basin Production Sharing Contract Act, 1994 and its 2019 amendment.

The PIA seeks to stimulate long-term investments required in the industry to address the revenue demands of the Government, cater for host communities, and provide an enabling and transparent environment for operators in the industry, as well as resolve other challenges facing the industry. Indeed, the PIA, which contains 5 Chapters, 319 Sections and 8 Schedules is a crucial development

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needed to harmonise and create a definitive law on several issues plaguing the petroleum industry.

This Newsletter examines the key provisions of the PIA dealing with governance arrangement, licensing and regulation of upstream sector, licensing and regulation of midstream and downstream sector, rights of pre-emption, incorporated joint ventures, domestic base price and pricing framework, pricing formula for gas price for the gas based industries, capital and production allowances, cost price ratio limit, petroleum Fees, rents and royalty.

HIGHLIGHTS OF THE PROVISIONS

Governance Arrangements

The PIA starts with governance and institutional framework for the Nigerian petroleum industry. It formally segment the industry into four distinct sectors; the Ministry of Petroleum, the Upstream Sector, the Midstream and Downstream sector, and the Nigeria National Petroleum Company Limited (**NNPC Limited**) – successor for the Nigeria National Petroleum Corporation (**NNPC**). The upstream sector is to be overseen by the Nigerian Upstream Regulatory Commission (**the Commission**), while the midstream and downstream sector would be under the oversight of the Nigerian Midstream and Downstream Petroleum Regulatory Authority (**the Authority**). The general oversight powers over the petroleum industry is vested in the Minister of Petroleum (the Minister), whom the Commission and Authority are required to report to.

Supervisory Powers of the Minister of Petroleum

Section 3 of the PIA retains the Minister of Petroleum's general oversight and supervisory powers over all facets of the petroleum industry. This remains unchanged from the previous governance regime under the Petroleum Act. Specifically, the Minister is empowered to formulate, monitor, and administer the Federal Government's policy over the petroleum industry. The Commission and Authority are required to report to the Minister, ensuring his oversight powers over the industry are total. However, there have been important deviations from the general powers of the Minister as hitherto granted under the previous regime. A glaring change is that the Minister's former unfettered, sole discretion and power to grant or revoke oil licenses have been curtailed. The PIA specifically requires that the Commission provide recommendations to the Minister before the Minister can exercise such powers.

Powers of the Nigerian Upstream Regulatory Commission

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Section 4 of the PIA establishes the Nigerian Upstream Regulatory Commission to have primary regulatory powers and oversight over the technical and commercial activities of the upstream petroleum industry. The Commission will regulate all technical activities in the upstream sector by enforcing, administering, and implementing all laws, regulations, national and international policies, standards, and practices relating to the sector. The Commission is also to enforce compliance with the conditions of all leases, licences, permits and authorisations issued to companies in the sector. Such technical activities include seismic operations, drilling operations and design, construction, and operation of upstream facilities, among others. Given that the Department of Petroleum Resources (DPR) previously exercised these powers, it is clear that the Commission would replace the DPR in that regard as Section 10 vests the Commission with the power as the successor to the DPR and the Petroleum Inspectorate Division.

The PIA further empowers the Commission to oversee commercial activities in the upstream, such as reviewing and approving commercial aspects of field development plans, supervising costs and cost control in upstream petroleum operations, implementing cutback orders by the Minister. It seems safe to surmise that the Commission is to take over some of the commercial regulation previously undertaken by NNPC's National Petroleum Investment Management Services (NAPIMS).

Powers of the Nigerian Midstream and Downstream Petroleum Regulatory Authority

Section 29 of the PIA establishes the Nigerian Midstream and Downstream Petroleum Regulatory Authority to have technical and commercial regulation of midstream and downstream petroleum operations in the midstream and downstream segments of the petroleum industry. The Authority's functions include the regulation of petroleum liquid operations, domestic natural gas operations and export natural gas operation. The Authority shall determine the appropriate tariff methodology for processing of natural gas, transportation and transmission of natural gas, transportation of crude oil, bulk storage of crude oil and monitoring the quality of service provided.

The Authority is empowered to issue regulations in pursuance of its regulatory oversight powers. The Authority is empowered to impose a gas flare penalty for midstream operations, which will be to the credit of the Midstream and Downstream Gas Infrastructure Fund, and thereafter utilized for midstream gas infrastructure investment within the host community where the flare occurs. The objective is to compensate the host community for the environmental damage caused by the flaring or venting.

Interestingly, the PIA seems to suggest that the sole power to grant, issue, modify, cancel, or terminate all licences, permits and authorisations for midstream and downstream petroleum operations, is vested in the Authority.

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This is a significant departure from the previous regime whereby such powers were typically vested in the Minister. The powers vested in the Authority seem to indicate that it is taking over the functions of the NNPC (PPMC) and the PPPRA.

Incorporation and Commercialization of the National Petroleum Company Limited

Section 53 directs the Minister to incorporate NNPC Limited at the Corporate Affairs Commission ('CAC') within six months of the PIA's commencement. This means NNPC Limited shall be a commercially oriented and profit-driven national petroleum company" independent of government and audited annually. The shares are to be held by the Ministry of Finance Incorporated and the Ministry of Petroleum Incorporated in equal proportions on behalf of the Federal Government. The PIA provides that the Minister of Petroleum and the Minister of Finance are to determine which assets, interests, and liabilities of the current statutory NNPC, are to be transferred to NNPC Limited.

The PIA specifies that the company must pay its fair share of royalties, fees, rents, taxes and other payments due to the Federal Government, and that it should pay out the bulk of its profits as dividends after retaining 25% for reinvestment. Section 58 indicates that the Board of NNPC Limited is to be constituted in accordance with the provisions of the Companies and Allied Matters Act (CAMA), Memorandum & Articles of Association, and Shareholders' Agreements.

The Administration of Upstream Petroleum Operations

The PIA provides that the Nigerian Upstream Regulatory Commission shall regulate the upstream subsector of the Nigerian Oil and Gas industry. The Commission is expected to perform similar technical and commercial regulatory functions previously performed by DPR.

The areas of influence of the Commission in the upstream oil and gas sector include granting licences or lease such as petroleum exploration licence, petroleum prospecting licence and petroleum mining lease, to operating companies incorporated and validly existing in Nigeria under CAMA; monitoring and ensuring compliance with the PIA with respect to environmental sustainability and environmental degradation that may result from petroleum operations of licensees and lessees; gas flaring management in the Nigerian Oil and Gas sector; domestic crude oil supply obligations; and domestic gas delivery obligation.

The Administration of Midstream and Downstream Operations

The Nigerian Midstream and Downstream Petroleum Regulatory Authority shall be responsible for the management and administration of the midstream and the downstream sector of the Nigerian Oil and Gas Industry. The notable administrative areas of influence

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by the Authority include granting, renewing, modifying and extending licences and permits to operators in the midstream and downstream sector. The Authority has the power to use Regulations to determine the pricing framework for transportation, distribution and processing of petroleum.

The Authority, prior to establishing a tariff methodology, is required to initiate and conduct a stakeholders' consultation with applicants, operators, consumers, prospective customers, consumers associations, associations of prospective customers and any other persons with interest in the subject matter of the proposed tariff methodology. Notwithstanding the requirements for stakeholders' consultation, the Authority may establish a tariff methodology without conducting a stakeholders' consultation, where it considers it necessary to do so. According to the PIA, such tariff methodology so determined shall be valid for only six months subject to confirmation via due process of stakeholders' consultation.

The Administration of Midstream and Downstream Gas Operations:

The PIA requires a holder of a subsisting lease, licence or permit, who is engaged in activities in midstream or downstream gas operations prior to the effective date of the PIA, to apply to the Authority within 18 months from the effective date of the PIA for the appropriate licence or permit, as applicable. In order to properly administer gas operations in the sector, the PIA provides that the Authority can issue special guidelines and regulations as may be deemed necessary. The Authority performs the customer-protection function by issuing regulations that require oil and gas product distributors and suppliers to publish their terms of supply or distribution including tariffs, and facilitate the establishment of a forum at which customers are able to express their views and raise concerns, among others.

The PIA provides that the Authority shall, prior to the 1st day of March of each calendar year, determine the domestic gas demand requirement and inform the Commission of this requirement.

Conversion and Relinquishment of PPLs & PMLs

All existing Oil Prospecting Licences (OPLs) and Oil Mining Leases (OMLs) would be automatically converted to Petroleum Prospecting Licences (PPLs) and Petroleum Mining Licences (PMLs) upon their expiration. However, the PIA allows holders of OPLs and OMLs under the current regime to voluntarily covert them to PPLs or PMLs, respectively. The PIA provides some condition precedents, which are to be contained in the Conversion Contracts. One such condition is a stipulation that all on-going arbitration and court cases would be terminated.

OML holders will need to designate their acreages into five broad classes: parcels that merit an appraisal (for exploration); parcels to make a declaration of commercial discovery for which a field development plan is to be submitted;

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parcels that have a significant gas discovery; parcels which already have development programs underway; and parcels in which regular commercial production is occurring. The PIA prescribes that these five parcels should cover 40% of the area of the license granted, and other areas are to be relinquished. However, where the parcels cover more than 40%, the licensees will be entitled to keep them.

Introduction of Petroleum Host Communities

The main objective of Petroleum Host Communities is to foster sustainable prosperity within host communities, provide direct social and economic benefits and enhance harmonious co-existence. The Host Community provision is one of the issues that contributed to the delay in passing the previous versions of the PIA. The host communities, Government and operators could not agree on the best way to address the concerns of the host communities. While the host communities are demanding more to deal with the issue of the environmental effect of oil operations, the government believes that enough is already being done in this area given all the agencies that are involved in the development of the Niger Delta region.

Chapter 3 of the PIA introduces the Petroleum Host Community Development (PHCD). The PHCD is expected to improve the quality of life of the host communities' population and improve accountability in the management of host communities' development trust (HCDT or the Trust) fund. Section 235 of the PIA requires a settlor or a group of settlors under a joint operating agreement to incorporate a HCDT. The Trust is to aid the development of the economic and social infrastructure of the communities within the petroleum-producing area. Where the HCDT is incorporated by a group of settlors under a joint operation, the operator under the agreement will be responsible for the Trust on behalf of the other parties. The Act requires the settlor to appoint and authorise a Board of Trustees (BoT), which will be registered with the CAC, for the purpose of managing the Trust. Further, Section 251 requires the settlor to conduct a host community needs assessment to determine the needs of each host community and develop a Community Development Plan to address the identified needs.

Introduction of the Petroleum Industry Fiscal Framework

Chapter 4 of the PIA introduces the Petroleum Industry Fiscal Framework (PIFF). The objectives of PIFF include establishing a progressive fiscal framework that encourages investment in the Nigerian petroleum industry; balancing rewards with risk and enhancing revenues to the Federal Government; providing a forward-looking fiscal framework that is based on core principles of clarity, dynamism and fiscal rules of general application; establishing a fiscal framework that expands the revenue base of the FG, while ensuring a fair return for investors; simplifying the administration of petroleum tax; and

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promoting equity and transparency in the petroleum industry fiscal regime.

The PIA amends and repeals various laws that have implications for the oil and gas industry. It provides for the current Petroleum Profits Tax (PPT) to be split into two namely: Hydrocarbon Tax (HT) and Companies Income Tax (CIT). The HT, together with CIT, will apply to companies engaged in upstream petroleum operations. The fiscal and tax amendments in the PIA will apply upon conversion of existing OPLs and OMLs to PPLs and PMLs; termination or expiration of unconverted licenses; and renewal of OMLs. Consequently, holders of OPLs and OMLs that do not convert to PMLs will continue to be taxed under the current PPT Act pending the expiration of their licences.

Introduction of Hydrocarbon Tax Regime

The PIA introduces Hydrocarbon Tax (HT), which will be chargeable on the profits of upstream petroleum companies in the onshore and shallow water. The HT, which applies to crude oil, field condensates and natural gas liquids from associated gas, is charged at varying rates depending on the licence. The HT will not apply to deep offshore projects in order to encourage exploratory activities in that area. Given that HT is a resource tax, costs that cannot be directly attributable to production will not be allowable for deduction. However, such costs will qualify for deduction against CIT.

Ascertainment of crude oil revenue

Section 262 of the PIA provides that the crude oil revenue of a company, in any accounting period, shall be the value of any chargeable oil adjusted to measurement points based on proceeds of all chargeable oil sold and value of chargeable oil disposed of. The value of chargeable oil disposed shall be based on the aggregate value of crude oil determined for royalties for all fields. Therefore, extraction, storage and transportation costs will no longer be added back in determining taxable revenue under the HT as is the case under the PPT regime. Further, income incidental to petroleum operations would not be taxable under HT.

Submission of returns and penalties for non-compliance

The requirements for submission of tax returns to the FIRS are similar to that in the PPTA. Based on Section 277 (3) of the PIA, companies yet to commence bulk sales or disposal of chargeable oil are required to submit their tax returns within 18 months from the date of incorporation in the case of a new company, and within 5 months after any period ending on 31st December of the following year, in the case of any other company. Further, Section 281 of the PIA has significantly increased the general penalty for non-compliance from ₦10,000 and an additional ₦2,000 for each day of continued default to ₦10,000,000 and an additional ₦2,000,000 for each day of continued default. The stiff penalties are to encourage voluntary compliance. However, Section 218 provides for taxpayers that have genuine reasons that may impact their ability to file their tax

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returns as and when due to proactively engage the FIRS and agree an extension to avoid payment of the penalties.

Interest on revised estimated tax returns

Section 280 (2) requires companies to re-compute and file a revised estimated tax return (ETR) whenever there are changes in the price or cost or volumes of condensates. Failure to submit a revised ETR will result in the imposition of interest at LIBOR + 10% on the additional tax that would have been payable if a revised return had been submitted. Although submission of a revised ETR is not new to the companies operating in the upstream industry especially where the parameters that informed the initial estimate change, however, the imposition of interest for not revising the estimate may be considered harsh given the frequency of volatility in the industry. Interestingly, the PIA is silent on what would happen if a company fails to file a revised ETR, which results in a lower tax payable.

Non-allowable Deductions

In addition to the usual disallowable expenses, section 264 of the PIA introduces expenses that are non-deductible expenses. These non-deductible expenses include penalties and gas flare fees; expenditure for the purchase of information on existence and extent of petroleum deposits, except in respect of geophysical, geological and geochemical data and information; financial/ bank charges, bad debts, interest on loans, arbitration and litigation costs; Costs incurred outside Nigeria including head office, shared costs, research and development cost and affiliate costs; additional costs from tax gross-up clauses; production/signature bonuses, bonuses/ fees paid for renewing leases and licenses or for assigning rights to other parties; all custom duties; costs that exceed the cost price ratio limit of 65% of gross revenue.

Chargeable Profits and Allowances

The PIA makes significant modifications to the calculation of chargeable profits and allowance. These significant changes include removal of the restriction on capital allowance (CA); introduction of production allowances to replace the investment tax allowance and investment tax credit; deletion of petroleum investment allowance; and separation of acquisition costs of petroleum rights into value of rights and value of assets such that CA claimable on value of rights will now be 20% per annum for the purposes of CIT. However, for HT purpose, the annual allowance on the value of rights portion will be 20% while the value of assets shall be tax depreciated at 20% per annum, subject to a retention of 1% in the books. The chargeable profits and allowances shall be determined separately for the two classes of assessable profits i.e assessable profits subject to HT at 30% and 15%, respectively.

Additional Chargeable Tax

Where the chargeable tax calculated by a company for any period is less than the

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chargeable tax for crude oil for the same period, the company will pay the difference between the two amounts as additional chargeable tax (ACT). The chargeable tax for crude oil is determined as the number of barrels of crude oil at the measurement point multiplied by the fiscal oil price per barrel established by the Commission at each measurement point on an export parity basis.

Cost Price Ratio (CPR) Limit

All deductible costs under the HT will be subject to a cost price ratio limit of 65% of gross revenues, subject to the relevant exclusions, determined at the measurement points. Any excess costs not deducted due to the restriction may be deducted in subsequent years of assessment provided that the total costs to be deducted shall not exceed the actual costs incurred. The CA shall be carried forward with priority over operating costs, and the total costs to be allowed as deduction in those subsequent years shall be such an amount that, if added to the sum of the total deductible costs, shall not exceed the specified cost price ratio limit of 65 percent.

Consolidation of Taxes

Companies engaged in upstream petroleum operations will be taxed under CIT and are required to settle their CIT liability on an actual year basis, using a similar estimate mechanism to that provided for HT. However, HT will not be deductible for CIT purposes. CIT will be applied as an entity-based tax, thereby allowing for consolidation of results across terrains. This means that there are no field-by-field restrictions. However, companies that acquire loss-making companies in other to take advantage of the above incentive would not be allowed to claim the losses of the acquired company.

The PIA provides that Companies, concessionaires, licensees, lessees, contractors or subcontractors involved in upstream, midstream and downstream petroleum operations will be liable to CIT. Allowable deductions under the PIA are modified to include rents and royalties incurred with respect to commercial sale; delivery or disposal of crude oil, condensates and natural gas and payments to the Federation Account related to production sharing, profit sharing, risk service contracts or other contractual features; any amount contributed to any fund, scheme or arrangement for abandonment and decommission, petroleum host communities' development trust, provided that the fund/ scheme/ arrangement is approved by the Commission or Authority and any surplus or residue; and other deductions as may be prescribed by the Minister of Finance by Order published in the Gazette.

Non-allowable deductions are revised to include expenditure for the purchase of information on the existence and extent of petroleum deposits except in respect of geophysical, geological and geochemical data and information; any penalty incurred, including natural gas flare fee or charges; production bonuses, signature bonuses paid for acquisition of rights on petroleum deposits, signature

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bonuses or fees paid for renewing PML or PPL or fees paid for the assignment of rights to other parties including for marginal field; and additional costs from tax gross-up clauses.

Power of the Minister to request Petroleum Products or take-over works, plants or premises

The PIA empowers the Minster to request license/ lease holders to provide petroleum products to the Federal Government or crude oil to third parties who own licenses to operate refineries. The price of the petroleum shall be at a "reasonable value at the point of delivery less discount to be agreed by both parties" or where no agreement was entered into before the Minister exercised the right of pre-exemption, a mutually agreed fair price at the port of delivery. Further, the Minister may take control of the licensee's or lessees' works, plants or premises in exchange for a "reasonable compensation".

Companies to separate upstream and midstream operations

Companies engaged in the end-to-end value chain will have to segregate upstream from their midstream operations. This may have a negative impact on the profitability of those midstream projects as the final investment decision (FID) was predicated on the consolidation of both operations. This may also trigger significant issues for existing operators especially with respect to current pipelines, transfer of assets/ liabilities, transfer of staff and related obligations, compliance costs, transfer-pricing issues. However, the PIA provides for a tax neutral segregation of upstream and midstream/downstream operations. It specifically states that CGT and stamp duties will not apply on segregation. However, strategic projects can be allowed as integrated projects provided that the oil and gas will be processed or refined to finished petroleum products and supplied wholesale solely to the domestic market. In this situation, arm's length transfer prices will have to be established to fiscalise the hydrocarbons transferred to the midstream operations. In addition, capital investment in the midstream operations will be consolidated with that of upstream petroleum operations.

PSC Fiscal Stability Clause

The PIA provides that fiscal stability clauses, which serve as a guarantee or a sort of protection to investors against change in government policies or legislation provided by the NNPC in any PSC or any contract of similar nature, in respect of OPLs and OMLs to be converted will now be null and void. The discharge of these clauses will create a level playing field between old and new investors and address potential distortions that may have been created as a result of perceived discrimination.

Conversion of OPLs and OMLs.

The PIA would not apply to holders of OPLs or OML who have not converted their licences to PPLs or PMLs until such OPLs or OMLs are terminated. However, any renewal of an OML will be based on the PIA. Consequently, the provisions of

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PPTA will continue to apply to unconverted OMLs and OPLs.

Set off of payments made in error

Where a company makes tax payment in error, the PIA provides for setting off "the credit against the liabilities of a similar tax payable to the Service". Though the PIA does not clarify the applicable taxes under this provision, it is assumed that it will extend to CIT and TET as they are all taxes on income.

Calculation of Production Royalty, Gas Royalty and Price Royalty

The PIA provides that production royalty will be calculated on a field basis and would be chargeable on the volume of crude oil and condensates produced from the field area in the relevant month on a terrain basis. For onshore areas, the production royalty is 15 %; shallow water (up to 200m water depth) is 12.5%; deep offshore (greater than 200m water depth) with monthly production less than 50,000 bpd is 5%; deep offshore (greater than 200m water depth) with monthly production above 50,000 bpd is 7.5%; frontier basins is 7.5%. Where a single field covers two or more PMLs, the royalty shall be determined based on the total production from the field. In the Production Sharing Contracts executed by those operating above 10,000m, royalty rate is set as zero percent.

For natural gas and natural gas liquids, royalty will be on the chargeable volume in the relevant area at the rate of 5% of the chargeable value. However, the royalty rate for gas produced and utilized in-country shall be 2.5%.

The PIA provides that In addition to production royalty, companies would be liable to additional royalty when crude oil, and condensate prices exceed specified benchmark prices and are payable to the Nigerian Sovereign Investment Authority. For fields in onshore, shallow water and deep offshore areas, the royalty rates will apply as per number of barrels. The royalty for below US$50 per barrel is 0%; at US$100 per barrel is 5%; and above US$150 per barrel is 10%.

Stiffer Penalties

The PIA introduced stiffer penalties to encourage voluntary compliance, curb default and entrench integrity. Taxpayers should therefore ensure strict compliance with the provisions of the PIA to avoid unnecessary fines or penalties as they will be disallowed for tax purposes.

Domestic Gas Supply Obligation

The PIA prescribes that supply of gas to midstream gas export operations will not be allowed until the domestic supply obligations have been met. This provision may undermine contractual obligations already entered by the gas supplier before the commencement of the Act.

Conclusion

Crude oil dominates Nigeria's economy, accounting for around 90% of export earnings. The country has the largest oil and gas reserves in sub-Saharan Africa with an estimated 37bn barrels of oil and

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188 trillion cubic feet of gas. Yet for decades, the virtually ungovernable industry has been plagued by poor leadership, eye-watering corruption and environmental degradation.

Value has leached away through opaque licensing deals, unaccountable middlemen, a lack of refining capacity and graft in the government and state-owned NNPC. Sabotage and pipeline theft in the oil-rich Niger Delta have ensured that the taxpayer loses out on billions of dollars in annual revenues.

Nigerian administrations since the 1960s have with varying degrees of effort failed at reform. In the last 20 years, multiple governments have attempted to pass an all encompassing Petroleum Industry Bill (PIB), the scope and complexity of which has ensured repeated failure.

In September 2020, President Muhammadu Buhari sent a new PIB to the National Assembly for consideration by the Senate and the House of Representatives. After several months of scutiny, the bill passed on 1 July 2021.

The new PIA provides a legal, governance, regulatory and fiscal framework for the petroleum industry, the development of host communities and related matters. It is extensive in scope, covering the upstream, midstream and downstream sectors.

The governance arrangement is the fulcrum on which every other aspect of the industry rests. The separation of the regulatory bodies into the upstream on one hand and the midstream and downstream on the other hand is a welcome development that will ease governance of the industry as well as enable policies to be well structured to suit the needs of players per sector.

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