



SPOTLIGHT ISSUE

A CLOSER LOOK AT THE PETROLEUM INDUSTRY BILL (PIB)

SEPTEMBER 2015



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The following analysis was written and published over the period of August 2015. All information was correct at the time of publishing.

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<http://www.stakeholderdemocracy.org/sdn-blog/>

THE PIB:

REFORMING NIGERIA'S PETROLEUM INDUSTRY

THE PIB:

REFORMING NIGERIA'S PETROLEUM INDUSTRY



Crude petroleum is Nigeria's most important non-renewable energy source, contributing over 90 percent of the country's foreign exchange earnings and about 80 percent of recurrent and capital expenditure. The Nigerian oil industry has served only international and elite domestic oil interests, which is highlighted by the paradoxical reality that Nigeria exports crude oil but imports refined petroleum products for domestic consumption. Despite state ownership, Nigeria is not in control of its oil industry, which has enabled the growth of a chasm between oil wealth and development.

Whether or not the oil is to blame for Nigeria's shocking lack of development, there is clearly a need to reform the legislative framework that 'controls' the industry. Nigeria's mono-product economy has both destroyed traditional livelihoods as well as reducing the economic potential for the majority of citizens. While extractive practices have themselves polluted the environment, the lack of economic diversification has reduced employment options, leaving many with no option but to resort to illegal oil bunkering and artisanal refining which causes further environmental degradation.

The Nigerian government has long pledged its intent to overhaul the petroleum industry, entrenching efficiency and transparency in both upstream and downstream sectors, bringing operations in line with international standards. Yet the Petroleum Industry Bill (PIB), which seeks to increase government revenue from oil and lay down a strengthened legal and regulatory framework for the Nigerian oil industry, has suffered legislative delays and limited consideration from the executive, precluding its passage.

THE PIB:

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Reasons for the delay include fear of potential protests against any removal of the fuel subsidy arising from deregulation of the industry, concerns about regional imbalances in the distribution of oil revenues and, of course, mounting pressure from foreign oil companies who are unwilling to pay more oil taxes.

Due to its 14 years in preparation, the rejection of the PIB would be damaging to global perceptions of the future of the Nigerian economy. Thus SDN supports the ratification of the PIB, despite there being areas for strengthening and amendment.

The key objectives of the PIB are as follows:

- **Secure the long term macroeconomic stability of Nigeria**
- **Reform the Extractive Industry institutional framework**
- **Support production to ensure Nigeria remains the top African oil producer**
- **Kick-start a domestic gas to power market**
- **Provide clarity and stability for Nigeria and its partnership with the oil and gas industry for the next decade**
- **Increase oil and gas production whilst protecting the environment**
- **Support economic diversification of Nigeria**

SDN's independent analysis hails the proposed PIB for its ability to raise revenues, deregulate the industry and raise environmental standards. However, our analysis also highlights key areas in which the proposed legislation needs strengthening in order to deliver long-term sustainability and impact.

This month's blogs will place the PIB under the microscope, examining the Bill's potential for curbing Nigeria's hedonistic oil industry, to become more inclusive and accountable.

THE PIB:

THE PETROLEUM INDUSTRY BILL'S PROPOSED FISCAL REGIME

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THE PETROLEUM INDUSTRY BILL'S PROPOSED FISCAL REGIME

The yet-to-be passed PIB proposes a new fiscal regime for Nigeria's oil industry which would govern the economic benefits derived from petroleum exploration and production. The fiscal regime is a critical element of any oil industry which aims to balance Government tax-take with incentives to invest in oil exploration and production. In addition, robust legislation provides the foundations of relationships between operators, government and communities.

This article considers the implications of the fiscal regime currently proposed by the PIB; arguing that the bill will provide short-term gains for government revenue, while deterring long-term prospects for increased investment the offshore petroleum exploration.

FISCAL REGIME

The fiscal regime relates to the overall tax and cost implication imposed by the Federal Government of Nigeria on the oil industry. These relate mainly to Nigerian Hydrocarbon Tax, Companies Income Tax & Royalties.

NIGERIAN HYDROCARBON TAX

The PIB proposes that a Nigerian Hydrocarbon Tax (NHT) will replace the Petroleum Profits Tax (PPT). This will stand at 50% for onshore & shallow water exploration and 25% for deep-water activities.

New regulations on tax deductions will provide a disincentive for deep-water investment. Initial capital employed in production sharing contracts (these are a type of contract signed between a government and a resource extraction company concerning how much of the resource extracted from the country each will receive) will not be deductible.

This is a major source of concern to the oil operators because most production sharing contracts are in deep-water and have high capital costs.

There are also long-term ramifications to be considered. The majority of proven Nigerian reserves yet to be developed are held in deep-water offshore fields representing a significant opportunity for oil exploration and investment in the near to medium future. Therefore, if the PIB's aim of increase production is to be achieved then the new fiscal regime must promote investment in these offshore reserves.

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COMPANIES INCOME TAX (CIT)

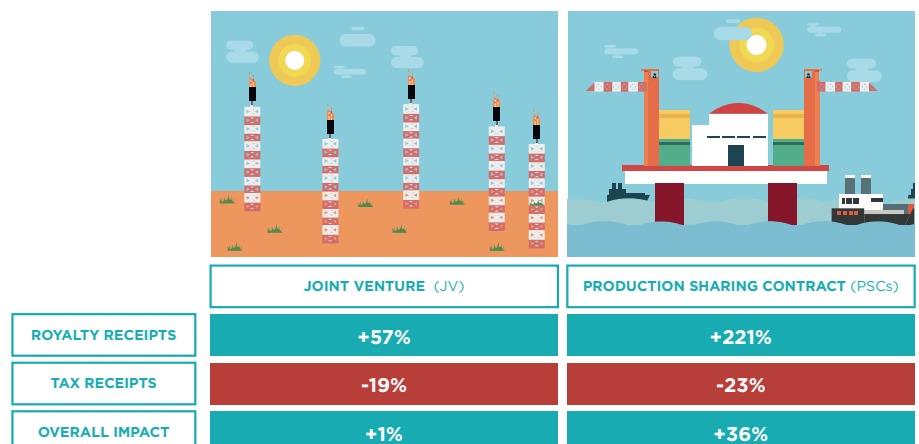
The major change is that CIT is now payable on upstream (exploration and production) operations. Companies involved in both upstream and downstream (refining and distributing) will have to compute CIT separately on each operation. Various tax incentives are offered for greater involvement in downstream oil investment. This is a great step towards incentivising the gas market and improving Nigeria's refining capacity.

ROYALTIES

Royalties are not specifically mentioned in the bill, but it gives the minister the right to change the system. A new system currently under examination makes the calculation of the royalty more complex. Prior to the bill, royalties were calculated to encourage deep-water exploration and the royalty rate was based simply only the position of the activity:

- Onshore:** 20%
- Shallow:** 18.5%
- 200 metres:** 16.67%
- 200-500 metres:** 12%
- 501-800 metres:** 8%
- 800-1000 metres:** 4%
- Above 1000 metres:** 0%

The scheme now under consideration combines location with both volumes and price, meaning that with higher rates of production per day, will warrant higher rates of taxation. This is a drastic change to the royalty regime that will lead to Nigeria being perceived as one of the least profitable regions to export oil and therefore globally uncompetitive.



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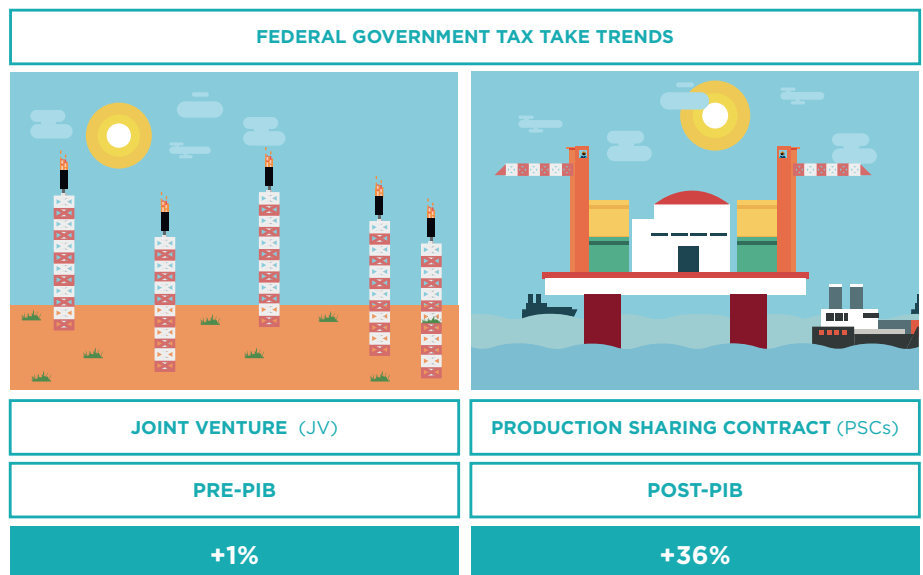
THE PETROLEUM INDUSTRY BILL'S PROPOSED FISCAL REGIME

SO WHAT WILL BE THE OVERALL IMPACT ON OIL REVENUES?

According to our independent analysis, the changes in the royalty and taxation regime will increase income to the Federal Government by approximately 7% per annum in the short term. The two new taxes – NHT and CIT combined – produce less revenue than the old Petroleum Profits Tax (PPT). It is the royalty provision that will increase the level of revenue if the PIB is passed. However, at current production levels, the bill will reduce incentives for deep-water production companies since these will be exposed to a harsher royalty regime than currently.

The key question, is this short term 7% increase worth risking Nigeria's future oil production?

To unlock the future potential of Nigerian exploration and production, there will therefore need to be a renewed thrust towards sustained investment in offshore fields. The PIB currently fails to do this and without negotiation in this area it risks alienating investments significant enough to support the future petroleum industry. The bill in its current state puts short-term gains ahead of long-term productivity.



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Oil-producing communities desperately need their rights enshrined by the federal government with regard to oil-spill compensation, environmental clean-up and improved socio-economic development of the operating regions. The PIB seeks to address these imbalances with the creation of Petroleum Host Community Fund (PHCF). According to the bill this will be a designated fund for “development of the economics and social infrastructure of the communities within the petroleum producing areas.”

Funds would be contributed on a monthly basis of a 10% of the net profit of the companies operating both onshore, in shallow water and the deep offshore.

HALF-BAKED?

In contrast to the Petroleum Development Fund and the other institutions set up under the bill, there is no provision for a board of directors, or other staff. The Fund’s entitlement, governance and management structure is left entirely in the hands of the Minister of Petroleum Resources. What is also not clear is the mechanism by which the PHCF could be expanded to include other states, if they also became oil-producing communities. It has to be geographically neutral.

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TO ADD TO THE AMBIGUITY

At present 3% of the total annual budget of all oil and gas producers goes to the Niger-Delta Development Commission Fund (N-DDCF). There is no provision within the PIB for the repeal of this provision, so the 10% going to the new fund is assumed to be in addition to the money going to the N-DDCF.

However, the clauses (sections 116-118) dealing with the new fund are also ambiguously drafted. On the one hand, the calculation of the 10% “net profit” is the adjusted profit less royalty, allowable deductions and allowances, less Nigerian Hydrocarbon Tax less Companies Income Tax.” This would imply that contributions to the fund are not deductible from any other taxation.

Yet the PIB goes on to say that “the contributions made by each upstream petroleum company pursuant to subsection (1) of this section, will constitute an immediate credit to its total fiscal rent obligations as defined in this Act.” This “total fiscal rent” is defined as “the aggregation of royalty, Nigerian Hydrocarbon Tax and Companies Income Tax obligations arising from upstream petroleum operations”. This would imply that contributions to the fund shall indeed be allowable against Nigerian Hydrocarbon Tax.

LOOPHOLES

Another contentious issue concerns the well-publicised issue of pipeline sabotage. Clause 118 (5) may cause difficulties over proof of pipeline damage: “Where an act of vandalism, sabotage or other civil unrest occurs that causes damage to any petroleum facilities within a host community, the cost of repair of such facility shall be paid from PHCF entitlement unless it is established that no member of the community is responsible.” Without a legitimate investigative process by which to examine oil damage, this clause of the bill may easily render the PHCF vulnerable to corruption and misuse.

In summary, the bill needs clarification as to the tax position of the revenue given to the PHCF and precisely how it is to be administered, or by whom. It is vital that this is clarified, since the PHCF proposal is the one aspect of the bill, where all the advantage goes to existing oil-producing states and not to Nigeria as a whole. Nowhere in the bill is it explained how the PHCF will be managed, nor its precise function fully explained.

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Environmental Implications of the Petroleum Industry Bill



The PIB is widely touted to overhaul the Nigerian petroleum sector for the better, getting a better deal for oil and sharing the revenues more efficiently. The PIB proposes the replacement of the Department of Petroleum Resources (DPR) with two new regulators, the Upstream Petroleum Inspectorate (UPI) and the Downstream Petroleum Regulatory Agency (DPRA).

Currently, the Department of Petroleum Resources (DPR) has the responsibility to run the petroleum sector, collect and manage revenue, and regulate the environmental impact of the sectors operations. Due to this wide remit, it is responsible for notable failings in the downstream sector of the industry. Most significantly; the failure to incentivise the domestic market for gas, and an overreliance on imports for domestic use due to insufficient refining capacity.

By separating downstream (exploration and production) and upstream (refining and distributing) regulation, these issues can be tackled more effectively.

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BUT WHAT ARE THE IMPLICATIONS FOR THE ENVIRONMENT?

The Bill provides the chance to remove the responsibility of environmental regulation from the DPR, and vest it in a more independently financed and managed institution, which can prioritise reviewing negative impacts on the environment objectively. In reinforcing the separation of upstream and downstream regulation, this would bring practice in line with international standards.

The clearest solution would be to establish a strong and independent quasi-governmental body under the Ministry of Environment with sole responsibility for regulating the environmental impacts of the oil industry.

This would follow successes of the Economic and Financial Crimes Commission (EFCC) and Nigerian Extractive Industries Transparency Initiative (NEITI) in enhancing justice.

REDUCING GAS POLLUTION

Gas flaring is responsible for a decrease in agricultural yield, depression in flowering and fruiting in Okro and palm trees, deformities in children, liver damage and skin problems, increasing concentrations of airborne pollutants, acidification of soils and rainwater, corrosion of metal roofs and significant increases in concentrations of sulphates, nitrates and dissolved solids, with associated socio-economic problems.¹ Natural gas is associated with oil production. To simply switch off the flare stacks would inevitably substantially reduce the oil production that sustains the Nigerian economy.

The PIB aims to reduce gas flaring, create deregulated natural gas market through a domestic supply obligation and establishing a domestic price for gas. The PIB legislates the non-deductibility of penalties relating to gas flares, as previously these costs were deductible removing any incentive for IOCs to utilise their gas outputs. Companies would therefore incur financial costs for continuing to flare gas.

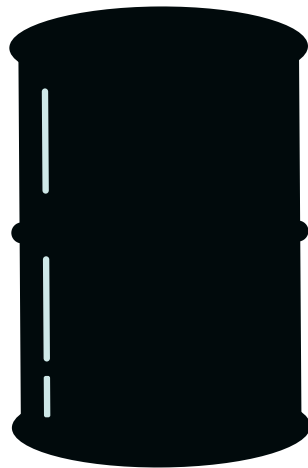
¹ E. Olugunorisa, A Review on the effects of Gas flaring on the Niger Delta Environment, International Journal of Sustainable Development & World Ecology, Volume 8, Issue 3, 2001

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MISSED OPPORTUNITY: GAS FOR POWER

The PIB also presents an opportunity for the government to kick-start a domestic gas market. This would create demand for companies to utilise their gas, whilst providing a solution to the ongoing problem of power shortages. However, the bill is yet to stipulate a sustainable incentive for companies to stimulate the gas market, or create a new National Gas Company, to build both processing units and pipelines. Incentives could include a tax break from the Companies Tax Income. The quickest means to secure compliance of IOCs in the reduction of flaring will be to incentivise the gas market, making gas a valuable commodity.

The PIB in its current form makes merely tentative steps towards greater protection of the environment. Removing the responsibility of environmental protection from the DPR means there is a chance to have an objective body that will prioritise environmental issues. However, the body that would take on this responsibility is yet to be conceived. Furthermore, whilst ensuring gas flaring incurs a financial burden, the PIB does not create incentives to kick start the gas market. Creating a demand for gas will be the most effective way of holding IOCs to account if they fail to utilise their gas outputs.



DIESEL
\$157 pmwh



GAS
\$51 pmwh
 Gas mmbtu price at \$5.50

GAS POWER WOULD SAVE
\$106 pmwh

CONCLUDING REMARKS

The Nigerian government has often reiterated that its major policy priority is to enthrone transparency and efficiency in both upstream and downstream sectors of its petroleum industry, bringing it in line with global best practice. Yet the PIB, which seeks to increase government revenue from oil and lay down a more robust legal and regulatory framework for the Nigerian oil industry, has suffered legislative delays and limited attention from the executive, forestalling its passage.

Reasons for the delay include fear of potential protests against any removal of the fuel subsidy arising from deregulation of the industry, concerns about regional imbalances in the distribution of oil revenues and, of course, mounting pressure from foreign oil companies who are unwilling to pay more oil taxes.

SDN supports the passage of the widely discussed Petroleum Industry Bill (PIB), as its rejection would be damaging to global perspectives of the Nigerian Economy.

SDN further laments the ambiguities of the bill, including its failure to produce incentives for a domestic gas market and its preference for short-term revenue increase over creating favourable circumstances for long-term investment.