UDO UDOMA & BELO-OSAGIE

UPDATE

NIGERIA AMENDS THE PRODUCTION SHARING CONTRACT ACT: AIMS TO INCREASE REVENUE FROM ROYALTIES PAYABLE BY PSC OPERATORS

Background

The Deep Offshore and Inland Basin Production Sharing Contract Act CAP D3 LFN 2004 (Amendment) Bill 2019 recently passed by the National Assembly has been assented to by the President to become an Act of the National Assembly (the "2019 Act"). The 2019 Act amended some sections of the Deep Offshore and Inland Basin Production Sharing Contract Act 2004 (the "2004 Act"). The amendments relate to the fiscal terms and policies of Production Sharing Contracts ("PSCs") in respect of deep offshore and inland basin areas, and the primary aim of the amendment, according to the President, is *"to reflect current realities and to ensure increased government revenues"*. This is because the 2004 Act, which came into effect on 1st January, 1993, granted certain fiscal incentives (such as a 0% royalty rate in respect of PSCs in areas in excess of 1,000m water depth and a petroleum profits tax on PSC operators at a flat rate of 50%) to promote investments in crude oil exploration by international oil companies ("IOCs") in Nigeria's offshore deep waters.

While the fiscal incentives helped to encourage investments by IOCs in deep shore exploration and led to a significant increase in Nigeria's crude oil reserves, the Nigerian government has stated that it did not derive adequate benefits from the rise in crude oil prices above US$20.00 per barrel from when the 2004 Act came into effect. Although the 2004 Act requires that the law should be amended periodically *"... to ensure that if the price of crude oil at any time exceeds $20 per barrel, in real terms, the share of the government of the Federation in the additional revenue shall be adjusted under the production sharing contracts to such extent that the production sharing contracts shall be economically beneficial to the government of the Federation"*, the law was not amended until October 2019. It was in order to address this issue to enable the Nigerian government to potentially earn additional revenue from PSC operators that led to the enactment of the 2019 Act.

We have highlighted in this article the key changes to royalties payments by PSC operators introduced by the 2019 Act.

Payment of Royalties

Under section 5 of the 2004 Act, royalties rates range from 12% to 0%, depending on the depth of the water in the area covered by a PSC. This section has now been deleted and replaced with a new section 5 in the 2019 Act. The amendment introduced fixed royalties and graduated additional royalties when the price of crude oil and condensate is at, or exceeds a prescribed threshold.

... fixed royalties

The 2019 Act provides that the new royalties for PSCs shall be calculated on a field basis on the chargeable crude oil or condensate at: (a) 10% in the deep offshore areas greater than 200m water depth; and (b) 7.5% in the frontier and inland basin areas. What this means is that royalties will be calculated on a field area basis and PSC operators in areas in excess of 200m water depth which hitherto paid graduated royalties of between 12% to 0%, depending on the water depth, will now be liable to pay royalty at a flat rate of 10%. On the other hand, PSC operators in the frontier and inland basin will now pay royalty at a flat rate of 7.5%.

... additional royalties

The amendment has introduced royalties by price. This involves the adoption of a new approach which is to ensure that royalties reflect the dynamic prices of crude oil, condensates and natural gas and to address the requirement to amend the statute every five years. As a result, the amendment introduced an additional royalty payment mechanism where the prices for crude oil and condensates exceed US$20.00 per barrel. The rates for the additional royalties shall be calculated as follows, prices per barrel above: (a) US$20.00 and up to US$60.00 - 2.5%; (b) US$60.00 and up to US$100.00 - 4%; (c) US$100.00 and up to US$150.00 - 8%; and (d) US$150.00 - 10%.

The above rates are required to be calculated separately, and shall apply to deep offshore of water depth beyond 200m and to frontier acreages, for crude oil and condensates. These additional royalties are aimed at ensuring that the Nigerian government receives additional revenue from PSC operators. Based on the introduction of this mechanism for additional royalties, section 16(1) of the 2004 Act, which requires periodic amendment, was deleted.

Review of PSCs

One of the changes introduced by the 2019 Act is

This update is for general information only and does not constitute legal advice. © 2019 Udo Udoma & Belo-Osagie

conferring on the Minister of Petroleum Resources the power to cause the Nigerian National Petroleum Corporation to call for a review of PSCs every eight years. Unlike in the past when PSCs were not reviewed periodically as required by the statute, the aim of this provision is to ensure that PSCs are reviewed periodically to address issues in relation to the changing nature of crude oil exploration and exploitation and the applicable penalty may be applied for failure to do that.

Penalty for Non-compliance

Unlike in the 2004 Act which has no penalties for non-compliance, the 2019 Act includes a new section which imposes penalty for non-compliance with the provisions of the statute as amended. The 2019 Act provides that any person who fails, or neglects, to comply with any obligations imposed by the statute commits an offence and is liable, on conviction, to a fine not below NGN500 million Naira or to imprisonment for a term not less than 5 years, or to both such fine and imprisonment. This is a huge penalty which could, on conviction, apply to persons that fail to comply with the obligations imposed on them by the statute as amended.

Conclusion

The implementation of the statute as amended would reduce the fiscal incentives which IOCs were hitherto entitled to under the 2004 Act. That could potentially translate to the Nigerian government receiving more revenue from oil and gas exploration under PSCs. President Muhammadu Buhari, following his assent to the amendment bill, summed up the objective for the amendment thus: *"Nigeria will now receive its fair, rightful and equitable share of income from our own natural resources for the first time since 2003".*

There is an ongoing debate on whether the reduction in fiscal incentives for PSC operators would discourage IOCs from further investments in deep offshore exploration activities, which could result in reduced revenue to the government. Notwithstanding the debate, PSC operators have not, to our knowledge, formally responded to the amendment or on any potential impact which it may have on investments in the oil and gas industry. The Nigerian government has, however, indicated that oil and gas business in Nigeria under PSCs will remain profitable and that the amendments mark the birth of a new and beneficial relationship between it and its partners in the oil and gas industry on a "win-win" basis.

Ahead of the implementation of the amendment, PSC operators need to carry out an assessment on the possible effects which the implementation of the 2019 Act will have on their operations and profitability. They also need to be mindful of the penalties for non-compliance with the provisions of the amended statute.

This update is for general information and does not constitute legal advice. Should you have any questions or require clarification regarding this or any other developments, please contact:

Lolade Ososami
Partner, Tax
lolade.ososami@uubo.org

Joseph Eimunjeze
Partner, Tax
joseph.eimunjeze@uubo.org

Emem Okoko
Associate
emem.okoko@uubo.org

© 2019 Udo Udoma & Belo-Osagie