



# An Analysis of the Nigerian Petroleum Industry Bill 2012

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Westpaq

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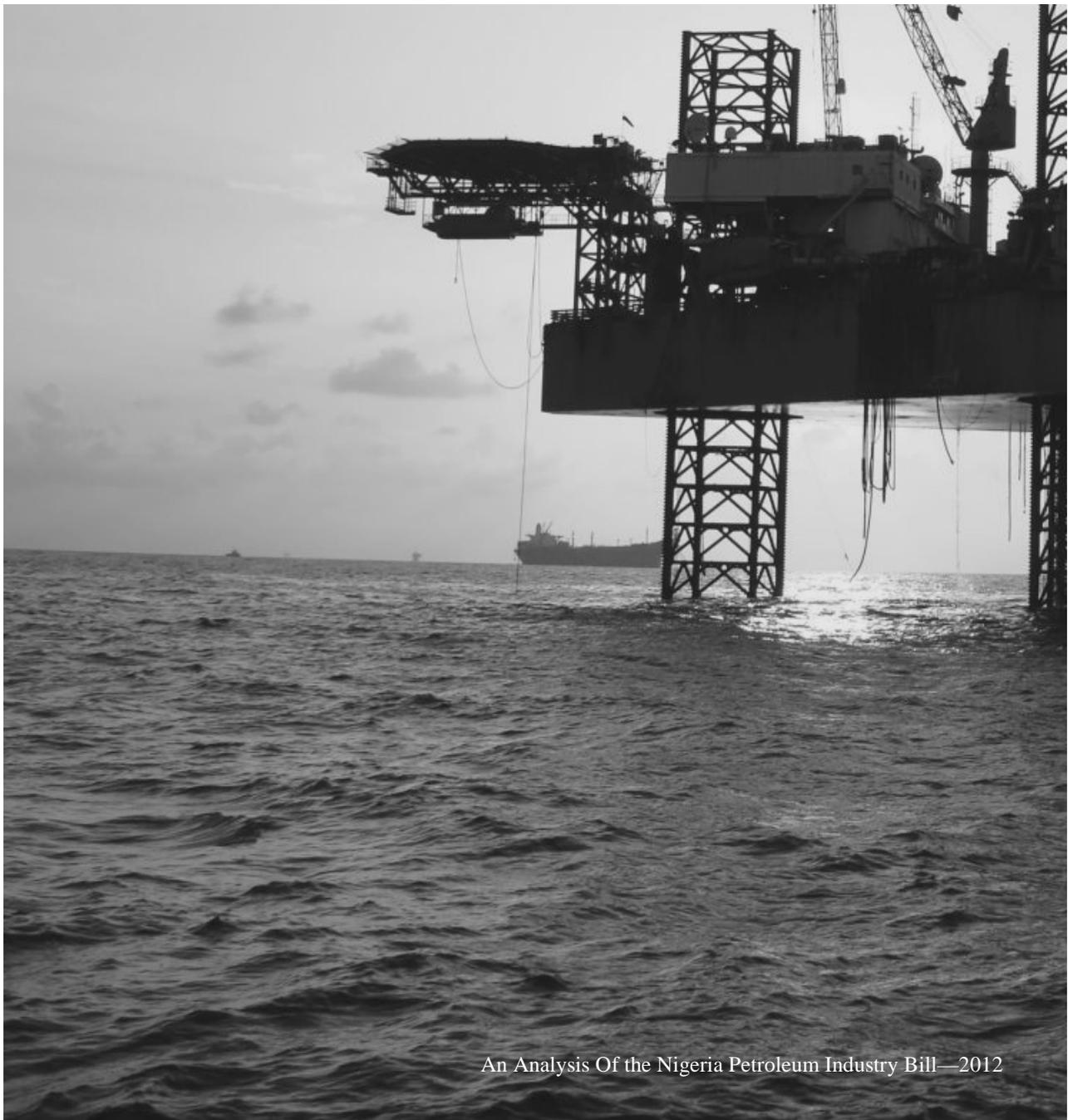
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# Introduction



An Analysis Of the Nigeria Petroleum Industry Bill—2012

## Introduction

The petroleum industry is the lifeblood of the Nigerian economy, official records from the budget office of the Federal Republic of Nigeria, shows that the petroleum industry accounted for about 29.1% of GDP and 78% of total government revenues through fiscal year 2012.

The PIB was conceived out of the need to bring the regulatory framework of Nigeria's oil and gas industry up to speed with global standards, it was first presented in 2008; it is an executive bill for an act to provide for the establishment of a legal, fiscal and regulatory framework for the petroleum industry in Nigeria and for related matters.

The current bill before the Nigerian legislators is the PIB 2012, which was presented by the President of the Federal Republic of Nigeria on the 18th of July 2012 to the National Assembly; it has received its second reading in both houses of assembly.

The next step in the legislative process towards passing the executive bill into law involves public hearings to be organized by the National Assembly. As various stakeholders prepare to present their positions and debate the contents of the bill, this report examines the PIB with a view to contributing to Nigeria's oil and Gas/Energy policy analysis and development.

### Changing Sub-Saharan Petroleum Exploration and Production

The Niger Delta basin, used to be the go to province for oil exploration in Sub-Saharan Africa, this trend may likely change if Nigeria does not resolve the uncertainty brought on by the long delay in passing the PIB into law, a process which began in 2008.

From new offshore discoveries in emerging West-African oil and gas host countries, Nigeria now faces potent competition for finite investments in a mix of mature and emerging oil plays, new deep-water gas across West Africa, and the new frontiers of East-Africa and the Transform Margin.

East Africa's emergence as a crude oil producer, natural gas discoveries off the coast of Tanzania and Mozambique, exploration in formerly no-go areas such as Somalia, is changing the game, investments in LNG plants in Mozambique alone could be three or four times the country's annual gross domestic product.

Reforms in Angola have led to stable oil and gas production, with a fully deregulated downstream sector and a commercial oriented National oil corporation in Sonangol. Gabon is at an advanced stage of passing a new Petroleum Code into law, with plans for deep-water licensing rounds in the last quarter of this year. Equatorial Guinea, Liberia, Sierra Leone, Cote d' Ivoire are other countries offering opportunities for viable offshore exploration on the East-Atlantic coast.

In the past 5 years, offshore West Africa has had a very high success rate for exploration in deep-water plays with shallow objectives. More West-African countries now provide an option for potential offshore discoveries.

Sub-Saharan Africa is being reshaped for a hydrocarbon revolution, and at this time, Nigeria needs to put her best foot forward if she intends to maintain an attraction for investments in the petroleum sector to enable a sustainable level of economic growth.

At this time, more than ever, the Nigerian petroleum Industry is in need of reforms to remain competitive in order to attract relevant investments necessary for the growth of the industry and the nation's economy. If Nigeria does not act appropriately and in time, we could see potential investments move elsewhere.

# Summary



## Summary

This report provides an analysis of the 'Executive Draft Nigerian Petroleum Industry Bill' (PIB) 2012. The PIB is an executive bill for an act to provide for the establishment of a legal, fiscal and regulatory framework for the petroleum industry in Nigeria and for related matters.

The key objectives of the bill as stated in Part 1 of the PIB are:

- A) Create a conducive business environment for petroleum operations
- B) Enhance exploration and exploitation of petroleum resources in Nigeria and for the benefit of the Nigerian people
- C) Optimize domestic gas supplies, particularly for power generation and industrial development
- D) Establish a progressive fiscal framework that encourages further investment in the petroleum industry while optimizing revenues accruing to the government
- E) Establish commercially oriented and profit driven oil and gas entities
- F) Deregulate and liberalize the downstream sector
- G) Create efficient and effective regulatory agencies
- H) Promote transparency and openness in the administration of the petroleum resources of Nigeria
- I) Promote the development of Nigerian content in the petroleum industry
- J) Protect health, safety and environment in the course of petroleum operations and
- K) Attain such other objectives to promote a viable and sustainable petroleum industry in Nigeria

To achieve the objectives of the bill, many details would need to be developed in subsequent regulation, and during the transition process, the PIB, if fine-tuned and effectively implemented, could lay the groundwork for the realization of its objectives. This report recommends those sections that need to be amended.

Objectives [C] and [I] are well on a positive trajectory, enhanced by ongoing progress in the power sector reforms as well as the implementation of the Nigerian Oil and Gas Industry Content Act 2010 (NOGIC Act). The Industry content Act is integrated into the PIB in Part VI of the bill, while this is commendable for enhancing local capacity; the provisions need to be diluted to prevent it from being counterproductive.

Objectives [A], [B], [G], [H], [J] and [K] should be achieved by the effective implementation of the 'Act' when passed into law, while the PIB is a step forward from existing Nigerian petroleum statutes, the main challenge in Nigeria's petroleum industry has been a lack of transparency, non-implementation of existing laws, mismanagement and corruption at the state enterprises and regulatory agencies.

Achieving the objectives of the PIB would rely a lot on a structural and balanced reformation of the regulatory institutions, the bill proposes to restructure the Nigerian National Petroleum Corporation (NNPC), this is most welcome, yet the bill ultimately fails to offer a clear path to more effective management of state owned enterprises and regulatory agencies.

A potent adversary against the effective management/operations of Nigeria's state owned oil enterprises and regulatory agencies, is political interference. The bill does not have sufficient provisions aimed directly at reducing unwarranted political interference in the state owned companies

In effect, the priority of the PIB should include creating legal and structural barriers as much as is possible between the state petroleum enterprises and regulatory agencies on one hand and the political institutions on the other.

Under the PIB, the President has the power to grant a petroleum prospecting/mining license or lease, section 191. This is in contradiction to section 190 that proposes open, transparent and competitive bidding processes.

The bill also gives the Minister of Petroleum the power to determine royalties by regulation, as well as issue permits for gas flaring; this report recommends that those provisions be amended before the bill is passed.

Based on detailed analyses of the PIB, this report concludes that the bill would not advance objectives [E] and [F].

This report concludes that objective [D] would be partially achieved by the PIB, while the fiscal framework encourages further investments focused on new production, it does not optimize revenue to the Federal Government.

There are several very generous allowances; tax holidays, tax-free zones, production allowances for existing and new fields, capital allowances for the entire life of fields; leading to a cumulative capital allowance of about 384% for a Petroleum Mining Lease with a 20yr term. The Petroleum Host Community Fund could also be credited against payments to government from royalties and tax, making it a net neutral tax for companies, and a loss of revenue for the Federal Government

This report concludes that the Petroleum Host Community Fund (PHCF) is a useful tool aimed at enhancing the smooth operations of the oil companies while providing direct financial benefits to host communities; it makes good business sense if properly managed. It could lead to a long-term reduction in production downtime from disputes between communities and oil companies, reduction in the massive security bills of the Oil companies, which in turn would enhance cumulative profit.

The PHCF is likely to enhance peace and stability in the Niger Delta, if the communities profit directly from production, an increase in production would result in an increase in funds to the PHCF's and vice versa. The net effect of the PHCF would be an increase in revenues for the government and the oil companies as a result of reductions in production disruptions.

The PIB proposes that revenues from onshore and shallow water production profits after deduction of allowances and expenses are to be distributed to communities directly, this report agrees with that provision as a useful policy for the overall benefit of production in the Niger Delta.

This report concludes that the proposal to distribute the PHCF accruable from Deep Water production to littoral states is unnecessary and would not serve any useful purpose; deep-water production should be exempted from the PHCF as a further incentive for new deep-water production. The pre-existing 13% petroleum derivation which goes to state governments, has not been utilized in the past for the benefit of the specific oil producing communities, it hasn't been applied to prevent discontent between petroleum producing communities and oil and gas companies, it is the ineffective application of funds meant for communities, that the PHCF should seek to correct.

This report concludes that the fiscal terms of the PIB are conducive for investment and profit when considered holistically alongside all other related allowances and tax breaks proposed under the PIB.

This report examines the nine (9) parts that make up the PIB in five (5) volumes.



## **PART 1**

### **OBJECTIVES**

This part outlines the objectives of the bill as follows:

- A) Create a conducive business environment for petroleum operations
- B) Enhance exploration and exploitation of petroleum resources in Nigeria and for the benefit of the Nigerian people
- C) Optimize domestic gas supplies, particularly for power generation and industrial development
- D) Establish a progressive fiscal framework that encourages further investment in the petroleum industry while optimizing revenues accruing to the government
- E) Establish commercially oriented and profit driven oil and gas entities
- F) Deregulate and liberalize the downstream sector
- G) Create efficient and effective regulatory agencies
- H) Promote transparency and openness in the administration of the petroleum resources of Nigeria
- I) Promote the development of Nigeria content in the petroleum industry
- J) Protect health, safety and environment in the course of petroleum operations and
- K) Attain such other objectives to promote a viable and sustainable petroleum industry in Nigeria

The outlined objectives are practical and achievable with the proper and effective implementation of the PIB. Achieving the objectives of the PIB would rely greatly on the institutions that manage state enterprise and those that regulate the industry.

## **PART 2**

### **INSTITUTIONS**

#### **A] The Minister**

The PIB gives the Petroleum Minister the right of pre-emption and the powers to make regulations, the bill leaves out several regulations for a later date after the bill is enacted, although the bill sets guidelines for the minister to make regulations necessary to give proper effect to the provisions of the Act, it leaves room for abuse and political interference in making regulations.

In section 8, the bill outlines the conditions and process required for the minister to make regulations, it outlines a process which is aimed at involving the input of stakeholders, some of those requirements include; the conduct of an inquiry.

However, the section also gives the minister the power to make any regulation without conducting an inquiry. Section 8 (6).

Subsequently, section 8 (7) stipulates that any regulation made pursuant to sub-section (6) shall be valid for no longer than twelve months. While subsection (7) serves as a check, it does not go far enough as political influence could be exerted via the office of the minister to circumvent the regulatory process by making regulations yearly towards the expiration of previously created regulation from subsection (6)

The powers of the minister to make regulations on a future date regarding royalty rates do not serve the objectives of promoting efficient and effective regulatory agencies; it leaves room for interference and manipulation.

Royalty rates should not be left to the discretion of a minister, it is recommended that regulations on royalties, rental rates, penalties for gas flaring etc. should be clearly spelt out in the bill before it is passed into law.

There is no good reason why such important matters are left out of the PIB, thus preventing them from the robust debates engendered by the legislative process. Such matters should not be reserved for a future event exempted from the legislative process and oversight.

While it is imperative that certain regulations would have to be made as budding subsectors of the petroleum industry develop, future regulations should involve an appropriate level of legislative oversight. Hearings and inquiries should be statutory and mandatory while new regulations should require legislative approval.

#### **B] Petroleum Technical Bureau (PTB)**

A strong team of experts and seasoned professionals would serve effectively to guide the Nigerian petroleum industry in the right direction.

The PTB should be strengthened and given the responsibility to formulate and develop government policy, propose future regulation or amendments and provide technical oversight on the petroleum industry. This should be in addition to developing strategies for exploration in viable frontier acreages and management oversight over the state petroleum enterprises and assets.

The bill proposes the PTB as a support and advisory body to the minister, this report recommends that the PTB should be given the responsibility and powers to perform the functions stated in the last paragraph, rather than the proposed limitations as an advisory and support bureau to the minister.

The PTB should be an independent body made up of experts and representatives of relevant industry stakeholders chaired by the petroleum minister.

Neither the minister, nor the president should have the powers to appoint more than 30% of its members. The bureau should be independent and reasonably free from political control. To achieve this, the PTB should be merged with the Petroleum Technology Development Fund (PTDF) and should be funded independently; its source of revenue should be the PTDF. A PTB composed as described above, would also serve to promote a more effective PTDF

C] Upstream Petroleum Inspectorate (UPI) & D] Downstream Petroleum Regulatory Agency (DPRA)

The success of the PIB would depend on the effective implementation of the laws by the relevant regulatory agencies. The PIB 2012 contains useful rules that should improve the standards of the petroleum industry if implemented effectively.

This report makes the following recommendations:

- Investment in the staff of the UPI & DPRA: employing and developing competent staff with very good remuneration and incentives can safeguard against corruption. Executive appointments should follow a code on corporate governance, which promotes best practices, principles of good governance and sets out mandatory training requirement.

- Empower professional, independent boards: they should have competent, politically autonomous members who are appointed through open, competitive process. Executives should be appointed based on their technical expertise rather than political patronage
- Statutory processes that promote transparency and public accountability: Mandatory performance reviews, audits and public reporting of all lease summaries, licenses and contracts
- Conduct annual audits to international standards

### **E] Petroleum Technology Development Fund (PTDF)**

The Petroleum Technology Development Fund is responsible for designing and implementing effective indigenous research and capacity development programs to provide knowledge, skills and adequate manpower for the petroleum industry.

This report recommends that the PTDF be merged with or put under the management of the PTB.

Please see Part 2] B of this report.

### **F] Petroleum Equalization Fund. (PEF)**

The functions of the PEF include reimbursement of petroleum products marketing companies for any loss sustained by them solely and exclusively as a result of sales by them of petroleum products at uniform prices throughout Nigeria, being benchmark prices set by the fund. PIB 2012, 104 [b]

An objective aimed at providing equal prices of any commodity across a country is unrealistic. There are no commodities that cost the same across the country.

Within a city, the cost of housing, groceries, transportation and commodities differ from one point to another.

Businesses do not operate for the purpose of making losses as the PEF statute implies. The functions of the PEF can hardly be achieved in a relative free market economy that Nigeria is, it creates opportunity for fraud and misappropriation. Petroleum products do not maintain equal prices across the country in spite of the efforts of the fund

### **Recommendation**

It is recommended that the PEF be scrapped.

It is important to note that scrapping the PEF would not be an easy task, it would be as difficult as stopping petroleum products' subsidy, both issues are determined more by Nigerian politics rather than the need for an effective petroleum industry policy.

### **G. Petroleum Host Community Fund (PHCF)**

The PIB 2012 proposes a PHCF Fund, which is to be utilized for the development of the economic and social infrastructure of the communities within petroleum producing communities. Section 117.

Under the bill, every upstream petroleum-producing company is required to remit on a monthly basis, ten percent (10%) of its net profit<sup>1</sup> directly to the PHCF for profits derived from on-shore and shallow areas<sup>2</sup>. For profits derived from deep-water areas<sup>3</sup>, all remittances are to be made to the fund for the benefit of producing littoral states.

The PHCF is likely to enhance peace and stability in the Niger Delta if the communities profit directly from production. An increase in production would result in an increase in funds to the PHCF's and vice versa, creating a symbiotic relationship between the host communities and the producing companies. In this scenario, the benefit and loss of one affects the other. The net effect of the PHCF is expected to be an increase in revenues for the government and the oil companies as a result of reduction in production disruptions.

### **Recommendations:**

The proposal to distribute the PHCF accruable from deep-water production to littoral states is unnecessary and would not serve the needs of the communities or the objective of preventing disruptions to oil production. Deep-water production should be exempted from the PHCF as a further incentive for new deep-water production.

The pre-existing 13% petroleum derivation which goes to state governments has not been utilized for the benefit of the oil producing communities nor has it been applied to prevent discontent between petroleum producing communities and oil and gas companies. It is the ineffective application of funds meant for the host communities that the PHCF should seek to correct.

Another question raised from the PHCF is the definition of communities under the PIB. It is recommended that already existing traditional structures be maintained. In the Niger Delta and across Nigeria, communities are very well defined.

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<sup>1</sup> Net profit for the purpose of Section 118, means adjusted profit, less loyalty, allowable deductions and allowances, less Nigerian Hydrocarbon Tax, less companies' income tax. PIB 2012, Section 118 (2)

<sup>2</sup> 'Shallow areas' refer to offshore production in shallow water. 'Shallow water' means areas in the offshore of Nigeria up to and including a water depth of 200 meters. PIB 2012, Section 363. Interpretations.

<sup>3</sup> 'Deep-water' means areas offshore Nigeria with water depth in excess of 200 meters. PIB 2012, Section 363. Interpretations.

Many communities have Community Development Councils/or Committees, traditional councils who own communal lands, and share benefits that come to their communities such as scholarships, employment quotas, sharing of community land, community development projects and so forth. Existing community structures have been well defined and rigid making it almost impossible to infiltrate them

**MODEL: INDORAMA ELEME PETRO-CHEMICALS**

Indorama Eleme Petrochemical Ltd (IEPL), located in Port Harcourt, Rivers state, Nigeria, was a 100% subsidiary of Nigerian Government-owned Nigerian National Petroleum Corporation (NNPC) with the name Eleme Petrochemicals Company Limited (EPCL). The Indorama Group acquired the EPCL under the 2006 privatization program in Nigeria.

Indorama Eleme Petrochemicals operates a model in which communities have a 7.5 % Equity Share Partnership. In the last few years, this has translated to an annual dividend of more than N4 billion per annum for six communities

With this model, the IEPL has gone on to be a very successful company, recording achievements of smooth and stable operations, enhanced production capacities, winning several global awards and certifications and has become a successful model of Nigeria's Privatization Program. Only recently<sup>4</sup>, the company signed a Project Financing Package for US\$ 1.2 Billion Greenfield Urea Fertilizer Plant in the same host community<sup>5</sup>.

**SECURITY COST IN THE NIGER DELTA**

Using Shell Petroleum Development Company (SPDC) as a case study, Shell spent about \$383 million on security between 2007 and 2009 in Nigeria. In 2008 alone, Shell spent more on security in the Delta than in the Americas, European Union (EU) and Russia combined<sup>6</sup>.

Enhanced peace and stability would greatly reduce security cost for oil producing companies while also enabling stable production in the Niger Delta.

While it is true that the PHCF would not be a silver bullet to eliminate all security or community/oil and gas company dispute in the Niger Delta, it would be a positive step towards addressing some level of dissatisfaction felt by host communities. The PHCF could end up being counter-productive if it is not managed properly.

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<sup>4</sup>In February 2013

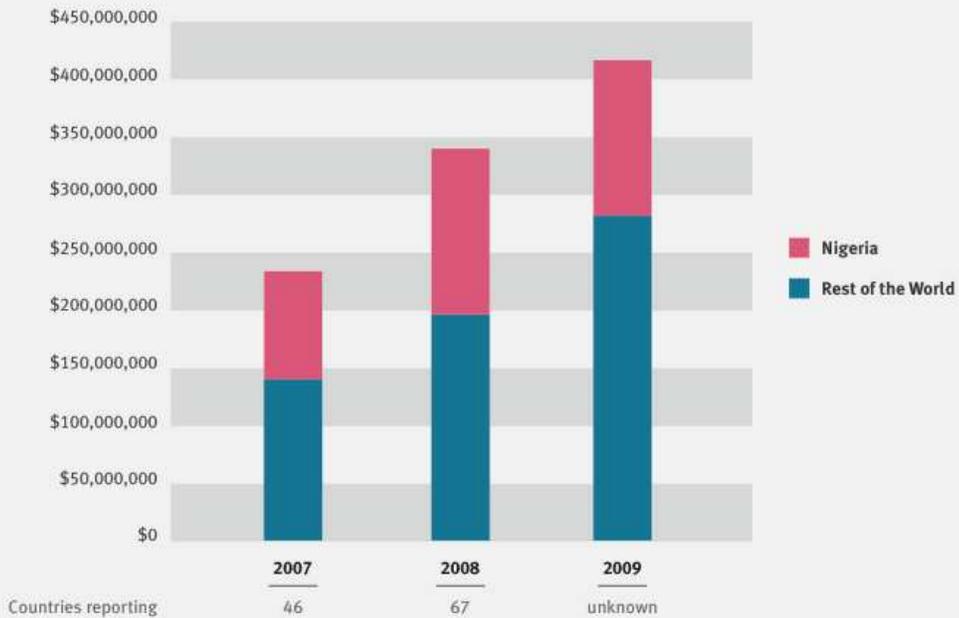
<sup>5</sup> For details on Indorama's Eleme Petrochemicals, please see the communities sub tab, under the social responsibilities tab on the company's website or on this link: <http://www.indoramaeleme.com/social-responsibilities.php?id=48>

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<sup>6</sup> (See Figures 1 and 2)

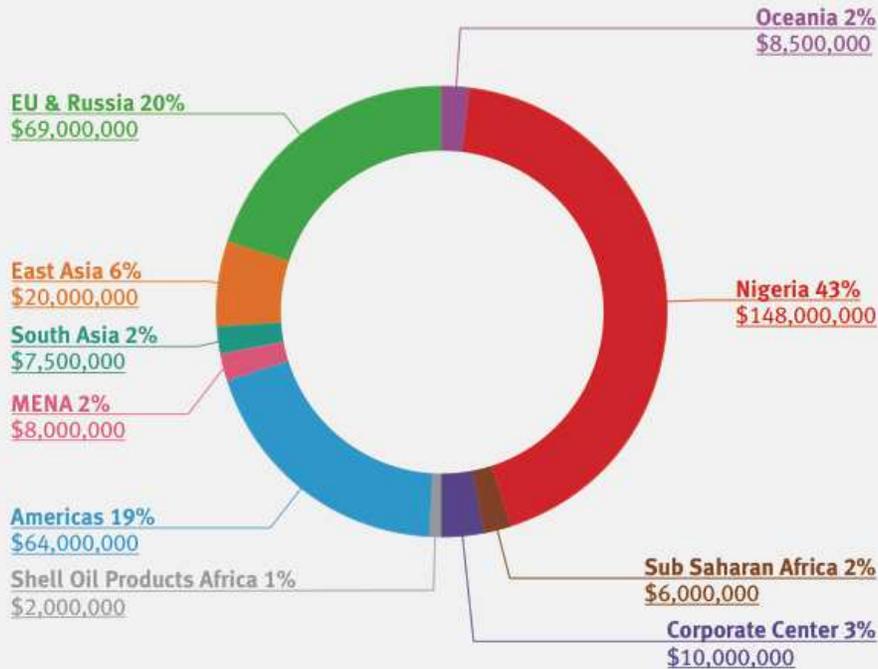
Figures 1 and 2 from Dirty Work: Shells Security Spending in Nigeria and Beyond—Ben Amunwa , Platform .

Figure 1. Shell Global Security Spending 2007-2009



Source: Shell 2007-2008 Comparison graph. 2009 figures from Platform interview with Shell manager, 7 October 2011

Figure 2. Shell Global Security Spending by Region 2008



Source: Shell 2008 Total Security Spend Region View

## **PART H], I] and J] The National Oil and Gas Companies.**

The PIB 2012 proposes to restructure the Nigerian National Petroleum Corporation (NNPC). The NNPC is to be broken up into three separate companies:

- The National Petroleum Assets Management Corporation (NPAMC).
- The National Oil Company
- The National Gas Company Plc.

### **The National Petroleum Assets Management Corporation (NPAMC):**

This agency would become the holding/management company for the investments of the Nigerian government in the upstream industry. It would replace the National Petroleum Investment Management Services (NAPIMS).

The function of NPAMC is quite vague in the PIB. One of its most important functions is 'to acquire and manage investments of the Government in the Nigerian upstream petroleum industry'. (Section 120). NPAMC would take over NNPC's interests in the current unincorporated joint ventures, production sharing contracts and upstream assets not currently operated and controlled by the Nigerian Petroleum Development Company (NPDC) or other subsidiaries

NPAMC would remain 100% government-owned with the minister presiding as chairman over its operations. It will be incorporated with 99% of shares held by NPAMC and 1% held by the ministry of petroleum resources. The corporation shall control all onshore/shallow water joint ventures between NNPC and the major oil companies.

The PIB proposes that the NPAMC would be funded by the Federal Government, with the NPAMC controlling a significant portion of Nigeria's upstream assets via the onshore/shallow water joint ventures. It is unlikely that the goals of commercialization, sustainable finance, limited political interference in technical decisions, transparency and public accountability would be significantly advanced .

### **National Oil Company and the Nigerian Gas Company**

The PIB proposes that the new NOC and NGC will be incorporated and vested with certain assets of the NNPC (mostly the NPDC assets). It proposes that within six years, the government shall divest up to 30% shares in the NOC and 49% of the NGC on the Nigerian Stock Exchange.

There is no government role in the appointment of the board nor its functions and powers. The NOC and NGC will also pay the hydrocarbon and corporate income taxes as other companies.

The proposal for the NOC and NGC is commendable, the following are recommended to improve on the process towards achieving efficient commercial operations:

#### **Recommendations:**

- The mandate of the NOC and NGC should be clearly defined
- There should be very clear terms on the shareholding rights of government
- Develop a clear, detailed achievable transition framework before the PIB is passed into law
- Fully define the NOC's financial obligations to the state during the transition stages.

- There should be a requirement for annual audits, performed to international standards and published for public access
- Statutory mandated hearings on NOC audited reports during the transition stages, as an appropriate level of oversight
- Appointment of at least 51% of board members from leading resource, legal and consulting companies to manage the company through the transition stages

The NGC and NOC do not need to be split into two companies, most of the gas produced in Nigeria is from associated gas fields, separating oil and gas companies in the Nigerian upstream may not be the most efficient option. A separate NOC and NGC would be more appropriate if Nigeria depended on gas imports and the role of the NGC is entirely focused on midstream-downstream operations such as gas importation, storage, processing, handling, transportation and distribution.

The name NOC may also not be the most appropriate for future brand marketing opportunities. None of the companies, which the NOC is being modeled after, adopted the name National Oil Company: Aramco, Petrobras, Petronas, Sonangol, Statoil are all examples. Branding plays a very significant role in modern businesses. National oil companies have inadvertently stuck with a negative reputation. The benefit of a commercial-oriented brand name would be useful in the future when or if the company develops to the point where it seeks to list in international stock markets.

Names such as *PetroNig*, *NigPetro*, *Petrocon* or a host of other names more suitable for commercial branding should be adopted.

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