

THE PETROLEUM INDUSTRY ACT 2021: A SUMMARY

INTRODUCTION

It is no longer news that crude oil dominates Nigeria's economy, accounting for about 90% of the country's foreign exchange earnings. For some years now, successive governments have attempted to pass an all-encompassing Petroleum Industry Bill to no avail. Now, the Petroleum Industry Act (the Act or PIA) has become law and establishes a new reality for Nigeria's oil and gas industry. The Act seeks to provide legal, governance, regulatory and fiscal framework for the Nigerian petroleum industry, the development of host communities and related matter.

The Act which vests the property and ownership of petroleum within Nigeria and its territorial waters, continental shelf and Exclusive Economic Zone in the Government of the Federation of Nigeria is divided into five chapters.

They are:

- A. Chapter one: Governance and Institutions
- B. Chapter two: Administration
- C. Chapter three: Host Communities Development
- D. Chapter four: Petroleum Industry Fiscal Framework
- E. Chapter five: Miscellaneous Provisions

OBJECTIVES

The key objectives of the PIA are as follows:

- To create efficient and effective governing institutions, with clear and separate roles for the petroleum industry;
- To establish a framework for the creation of a commercially oriented and profit-driven national petroleum company;
- To promote transparency, good governance and accountability in the administration of the petroleum resources of Nigeria; and
- To foster a business environment conducive for petroleum operations.
- To deepen local content practice in Nigeria Oil and Gas Industry

A. GOVERNANCE AND INSTITUTIONS

- 1. Establishment of the Nigerian Upstream Petroleum Regulatory Commission (the Commission);** according to Section 4 of the Act, this commission is to regulate upstream petroleum operations including technical, operational and commercial activities and to ensure compliance with all applicable laws and Regulations governing upstream petroleum operations. It shall be a body corporate with perpetual succession and a common seal. The Minister of Petroleum's (the Minister) existing powers to grant and revoke licences and to approve licence assignments now require recommendations from the Commission (Section 3).

- 2. Establishment of the Nigerian Midstream and Downstream Petroleum Regulatory Authority (the Authority);** the objective of the Authority is to regulate midstream and downstream petroleum operations, including technical, operational, and commercial activities and ensure efficient, safe, effective and sustainable infrastructural development of midstream and downstream petroleum operations (section 31). The objects and functions of the Authority are limited to midstream and downstream petroleum operations in the petroleum industry. Both the Commission and Authority are exempted from the provisions of any enactment relating to the taxation of companies or Trust Funds [Section 24(11) & 47(10)].

- 3. Incorporation of the Nigerian National Petroleum Company Limited (Section 53);** the Minister shall within 6 months from the commencement of this Act, cause to be incorporated under the Companies and Allied Matters Act (CAMA), a limited liability company, which shall be called Nigerian National Petroleum Company Limited (NNPC Limited). Ownership of all shares in NNPC Limited shall be vested in the Government at incorporation and held by the Ministry of Finance Incorporated and the Ministry of Petroleum Incorporated in equal portions on behalf of the Federation. This is to conform with the legal requirements of at least two shareholders required under CAMA. NNPC Limited is to operate on a commercial basis without government funding and must publish annual reports and audited accounts. The Minister and the Minister of Finance shall, within 18 months, determine the assets, interests and liabilities of NNPC to be transferred to NNPC Limited or its subsidiaries. NNPC shall cease to exist after its remaining assets, interests and liabilities other than its assets, interests and liabilities transferred to NNPC Limited or its subsidiaries under section 54(1) shall have been extinguished or transferred to the Government.
- 4. Establishment of Midstream and Downstream Gas Infrastructure Fund:** The Act establish this fund subject to the appropriation of the National Assembly, which shall be a body corporate with perpetual succession and a common seal. One of the major sources of this fund is levy of 0.5 % of the wholesale price of petroleum products and natural gas sold in Nigeria, which shall be collected from wholesale customers (Section 52). There shall be a Governing Council which shall supervise and make investment decisions for the fund.

B. ADMINISTRATION

5. **Objectives:** The objectives of this chapter include to promote the exploration and exploitation of petroleum resources in Nigeria for the benefit of the Nigerian people and promote sustainable development of the industry, ensure safe, efficient transportation and distribution infrastructure, and transparency and accountability in the administration of petroleum resources in Nigeria.

6. **Domestic Gas Obligations;** as part of its obligations, the Nigerian Upstream Regulatory Commission shall prescribe and allocate the domestic gas delivery obligation on all lessees (Section 110). As proposed, a lessee who fails to comply with the domestic gas delivery obligation shall incur a penalty of US\$ 3.50 per MMBtu not delivered, provided that, where the lessee has signed a gas purchase and sale agreement with a wholesale supplier of the strategic sectors, the penalty for failure to deliver shall be as stated in that agreement. The penalty amount may be adjusted as the Commission may prescribe in a regulation made under this Act. However, the Commission shall discontinue the imposition of domestic gas delivery obligations, where the Authority has determined that the natural gas market has attained full market status.

7. Granting of Licenses and Leases (Section 70); The Act provided for the following Licenses and Leases;

- a) Petroleum Exploration Licence (PEL) to be granted to qualified applicants, to carry out petroleum exploration operations on a non-exclusive basis. A petroleum exploration licence shall be for 3 years and may be renewable for additional period of 3 years subject to fulfilment of prescribed conditions, but shall not include any right to win, extract, work, store, carry away, transport, export or otherwise treat petroleum discovered in or under the licence area [Section 71(3)].
- b) Petroleum Prospecting Licence (PPL) to be granted to qualified applicants to drill exploration and appraisal wells and do corresponding test production on an exclusive basis and also carry out petroleum exploration operations on a non-exclusive basis. A Petroleum Prospecting License for onshore and shallow water acreages, shall be for duration of not more than 6 years, comprising of an initial exploration period of 3 years, and an optional extension period of 3 years. A petroleum prospecting license for deep offshore and frontier acreages, shall be for duration of not more than 10 years, comprising of an initial exploration period of 5 years, and an optional extension period of 5 years.
- c) Petroleum Mining Lease (PML) to be granted to qualified applicants to
 - i. win, work, carry away and dispose of crude oil, condensates and natural gas on an exclusive basis;

- ii. drill exploration and appraisal wells and carry out the related test production on an exclusive basis;
- iii. carry out petroleum exploration operations on a non-exclusive basis; and shall be for a maximum period of 20 years and may be renewable for one or more additional period of not more than 20 years each, subject to meeting specified conditions.

A licence or lease may be granted under this Act only to a company incorporated and validly existing in Nigeria under the Companies and Allied Matters Act.

In order to promote transparency, the Commission is required to call for bids in accordance with a procedure published on its website and in at least two international financial newspapers and two national newspapers with wide coverage. It is important to note Section 74(7) which provides for the inclusion of an electronic bidding process, open to the public and conducted in the presence of representatives of the Nigerian Extractive Industry Transparency Initiative, the Federal Ministry of Finance and the Federal Ministry of Petroleum Resources.

8. Model Contracts: The Commission is required to develop a model licence and model lease to include a carried interest provision giving the Government, through the NNPC Limited, the right to participate up to 60% in a contract (Section 85).

9. Prohibition of Gas Flaring (section 104); in a bid to fulfill its obligations under the United Nations Framework Convention on Climate Change (UNFCCC) and similar Conventions, the Act demands strict adherence to a gas flaring plan. A licensee or lessee producing natural gas is expected to, within 12 months of the effective date, submit a natural gas flare elimination and monetisation plan to the Commission, which shall be prepared in accordance with regulations made by the Commission under this Act. A Licensee or Lessee who fails to adhere to the provision shall pay a penalty prescribed pursuant to the Flare Gas (Prevention of Waste and Pollution) Regulations.

The Commission may however grant a permit to a Licensee or Lessee to allow the flaring or venting of natural gas for a specific period where it is required for facility start-up or for strategic operational reasons, including testing.

C. HOST COMMUNITIES DEVELOPMENT

- 10. Host Communities Development:** the objectives of this provision include to foster sustainable prosperity within host communities and to provide direct social and economic benefits from petroleum operations to host communities. It also seeks to enhance peaceful and harmonious co-existence between licensees or lessees and host communities.

In a bid to achieve these objectives, the PIA mandated that Settlers (a holder of an interest in a petroleum prospecting licence or petroleum mining lease or a holder of an interest in a licence for midstream petroleum operations, whose area of operations is located in or appurtenant to any community or communities) shall incorporate a trust for the benefit of the host communities for which the settlor is responsible (“host community development trust”).

Section 238 of the Act provides that unless where permitted under the Act, the failure of the holder of a licence or lease to establish the trust may be grounds for revocation of the applicable licence or lease. The constitution of each host community development trust shall provide that the applicable host community development trust fund be used exclusively for the implementation of the applicable host community development plan (Section 241).

The funds of the host communities development trust created pursuant to this Act shall be exempted from taxation.

- 11. Sources of funding for petroleum host communities development trust:** Each Settlor, where applicable through the operator, shall make an annual contribution to the applicable host community development trust fund of an amount equal to 3% of its actual annual operating expenditure of the preceding financial year in the upstream petroleum operations affecting the host communities for which the applicable host community development trust fund was established.

- 12. Board of Trustees;** In the composition of the Board of Trustees, the Settlor, in consultation with the Host Communities, shall determine the membership of the Board of Trustees to include persons of high integrity and professional standing, who shall come from the host communities. The Members of the Board of Trustees shall elect a Chairman from amongst themselves. Section 242(2)

- 13. Allocation of Funds;** Available funds are to be allocated 75% for capital projects, 20% as reserve and 5% for administrative cost of running the trust and special projects. However, a community will forfeit the cost of repairs in the event of vandalism, sabotage and other civil unrest causing damage to petroleum facilities or disruption of production activities.

D. FISCAL FRAMEWORK

- 14. Objectives;** one of the objectives of this provision is to establish a progressive fiscal framework that encourages investment in the Nigerian petroleum industry, balancing rewards with risk and enhancing revenues to the Federal Government of Nigeria. The Federal Inland Revenue Service has been saddled with the responsibility of administering and collecting Government revenue in the petroleum industry.

The fiscal and tax amendments in the Act will apply upon:

- i. conversion of existing Oil Prospecting Licences (OPLs) and Oil Mining Leases (OMLs) to Petroleum Prospecting Licences (PPLs) and Petroleum Mining Licences (PMLs);
- ii. termination or expiration of unconverted licenses, and
- iii. renewal of OMLs.

Consequently, holders of OPLs and OMLs that do not convert to PMLs will continue to be taxed under the current Petroleum Profit Tax Act pending the expiration of their licences.

- 15. Tax on Income Incidental to Petroleum Operations:** Unlike what was obtainable under the Petroleum Profit Tax Act, the Act does not include the phrase "operations incidental thereto".

16. Hydrocarbon Tax: this part applies to companies engaged in upstream petroleum operations in the onshore and shallow water. The Act proposes to replace the existing petroleum profits tax with Hydrocarbon Tax, which shall be charged and assessed upon the company's profits related to such operations and payable during each accounting period in accordance with the provisions of the Act (Section 261). This tax will only apply to crude oil, condensates and natural gas liquids from associated gas and is charged at varying rates depending on the licence as follows:

- Converted PML: onshore and shallow water 15%
- Converted PPL: onshore and shallow water 30%.

The Act also introduced a Cost Price Ratio (CPR), which restricts the allowable deductions claimable in each accounting period to 65% of the gross revenues determined at the measurement points, for the calculation of the Hydrocarbon Tax payable (Sixth Schedule).

17. Non-allowable Deductions: In addition to the usual disallowable expenses, section 264 of the Act introduces the following as nondeductible expenses;

- i. Penalties and gas flare fees;
- ii. Expenditure for the purchase of information on existence and extent of petroleum deposits, except in respect of geophysical, geological and geochemical data and information;

- iii. Financial/ bank charges, bad debts, interest on loans, arbitration and litigation costs;
- iv. Costs incurred outside Nigeria including head office, shared costs, research and development cost and affiliate costs;
- v. Additional costs from tax gross-up clauses;
- vi. Production/ signature bonuses, bonuses/ fees paid for renewing leases and licenses or for assigning rights to other parties;
- vii. All custom duties;
- viii. Costs that exceed the cost price ratio limit of 65% of gross revenue, etc.

18. Companies Income Tax (CIT): In addition to the Hydrocarbon Tax, Upstream petroleum operations shall also be subject to Companies Income Tax Act. The current rate of CIT is as follows:

- Small company with a turnover of N25 million or less = 0%
- Medium-sized Company with a turnover over N25 million and less than N100 million = 20%
- Large Company with N100 million and above = 30%

Any company involved in the upstream petroleum operations that is in default of payment of both the Hydrocarbon Tax and the CIT shall be liable to pay an administrative penalty of NGN 10,000,000 (Ten million Naira) and where the default continues beyond any period stipulated under the Act or a regulation, the person shall be liable to pay a further administrative penalty of NGN 2,000,000 (Two Million Naira) or such other sum as may by order be prescribed by the Minister of Finance, for each day the default continues (Section 297).

Late payment of tax due from companies involved in upstream operations shall carry interest at NIBOR plus 10% from the due date until paid for naira remittance, and LIBOR or succession rate plus 10% from the due date until paid for foreign currency remittance.

19. Calculation of Royalties

Both the price-based royalty and production-based royalties shall be paid together.

Production royalty will be calculated on a field basis and is chargeable on the volume of crude oil and condensates produced from the field area in the relevant month on a terrain basis as follows:

- i. onshore areas -15%
- ii. shallow water (up to 200m water depth) - 12.5%

- iii. deep offshore (greater than 200m water depth) with monthly production less than 50,000 bpd - 5%
- iv. deep offshore (greater than 200m water depth) with monthly production above 50,000 bpd - 7.5%
- v. frontier basins - 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 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 follows:

- i. Below US\$50 per barrel – 0%
- ii. At US\$100 per barrel – 5%
- iii. Above US\$150 per barrel – 10%

The price levels provided shall however apply only to the year 2020. At the beginning of 2021 and of each succeeding calendar year, these price levels shall be increased by 2% relative values of the previous year.

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%.

20. Production Incentives: The production allowance per field for crude oil production by a company for leases granted after the commencement of the Act shall be;

- For shallow waters, the lower of US\$8 per barrel and 20% of the fiscal oil price up to a cumulative maximum production of 100 million barrels from commencement of production and the lower US\$4 per barrel and 20% of the fiscal Oil price thereafter.
- For Onshore areas, the lower of US\$8 per barrel and 20% of the fiscal oil price up to a cumulative maximum production of 50 million barrels from commencement of production and the lower of US\$4 per barrel and 20% of the fiscal oil price thereafter.
- For deep offshore areas and frontier basin, the lower of US\$8 per barrel and 20% of the fiscal oil price up to a cumulative maximum production of 500 million barrels from commencement of production and lower of US\$4 per barrel and 20% of the fiscal oil price thereafter.

21. Preemption Right: The PIA empowers the Minister 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 (first schedule).

Any arbitration may only take place after the petroleum or petroleum products have been delivered. Furthermore, the Minister may take control of the licensee's or lessee's works, plants or premises in exchange for a “reasonable compensation”. It is hoped that this provision will only be invoked in an emergency and not exercised arbitrarily.

22. Unbundling: a person intending to operate in more than one stream (upstream, midstream, or downstream) of the petroleum industry must register and use separate companies for each stream. Where a company is required to unbundle itself into more than one company, capital gains tax and stamp duties will not apply under certain conditions. Section 302(3)(a).

E. MISCELLANEOUS PROVISIONS

23. The application of Public Officers Protection Act to any suit instituted against the Commission, Authority, the Commission Chief Executive, or the Authority Chief Executive, any Commissioner, or Director, Officer or Employee of the Commission or Authority. The effect of this provision is that where a cause of action arises against the Commission, Authority or any officer of the Commission or the Authority, a party must commence the action within three months of the accrual of the cause of action subject to the mandatory issuance of a one-month pre-action notice. This effectively creates a limitation period of two months for such action to be commenced or it will become statute barred.
24. The PIA repeals about 10 laws including the Associated Gas Reinjection Act; Hydrocarbon Oil Refineries Act; Motor Spirit Act; NNPC (Projects) Act; NNPC Act (when NNPC ceases to exist); Petroleum Products Pricing Regulatory Agency (Establishment) Act 2003; Petroleum Equalisation Fund Act; Petroleum Profit Tax Act; and Deep Offshore and Inland Basin PSC Act (Section 310).

It amends the Pre-Shipment Inspection of Oil Exports Act while the provisions of certain laws are saved until termination or expiration of the relevant oil prospecting licenses and mining leases including the Petroleum Act, PPTA, Oil Pipelines Act, Deep Offshore and Inland Basin PSC Act.



Kindly Reach us for more Information

TONBOFA Law Practice

E| lawyers2021@tonbofa.com

W| www.tonbofa.com

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.